



Tax Increment Financing District – City of St. Albans

Unauthorized Use of TIF District Debt
and Understatement of Tax Increment;
St. Albans Owes TIF District and State
Education Fund



Mission Statement

The mission of the Auditor's Office is to hold state government accountable.

This means ensuring that taxpayer funds are used effectively and efficiently, and that we foster the prevention of waste, fraud, and abuse.

This report is a work of the Office of the State Auditor, State of Vermont, and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from the State of Vermont or the Office of the State Auditor. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately. Please contact the Office of the State Auditor if you have questions about reproducing this report.

Dear Colleagues,

Vermont municipalities may establish a Tax Increment Financing (TIF) district in accordance with state law and TIF rules. A TIF district allows a municipality to designate an area for improvement, incur debt to finance infrastructure improvements, and earmark a portion of new state and municipal property tax revenues from that district to repay the debt.

One aim of these public investments is to stimulate private investment that would not otherwise have occurred, which would then lead to increased property values and new property tax revenue. A percentage of this new state and local tax revenue (increment) is directed to pay off debt associated with the districts instead of paying for public schools and municipal operations, which is how property taxes are typically used. In the case of the City of St. Albans, incremental property tax revenues have been insufficient to pay off the City's debt, which precipitated some of the City's non-compliance with Vermont statute.

In response to a series of TIF audits by the State Auditor's Office (SAO) in 2011 and 2012, the Legislature subsequently required the SAO to conduct ongoing audits of TIF districts for the purpose of evaluating municipal compliance with Vermont statute and TIF Rules. As spelled out in 32 VSA §5404a(l), these audits must include: "a review of a municipality's adherence to relevant statutes and rules ..., an assessment of record keeping related to revenues and expenditures, and a validation of the portion of the tax increment retained by the municipality and used for debt repayment and the portion directed to the Education Fund."

In auditing the St. Albans TIF district, the SAO found multiple instances where St. Albans did not comply with Vermont law and rules. For example, St. Albans:

- 1) Used TIF district debt proceeds (borrowed money) to pay debt service (principal and interest) of TIF district debt (on the same borrowed money), which is not allowed;
- 2) Used TIF district debt for site improvements of a private hotel development that were not authorized, as the costs were not in the description of the core brownfield improvement approved by The Vermont Economic Progress Council (VEPC) and were not described in materials made available in advance of the public vote to authorize TIF district debt financing for brownfield clean-up at the hotel site. This situation also raises questions about the extent to which public financing may be used for private development, rather than public infrastructure aimed at attracting that development;
- 3) Treated the parking garage constructed in the TIF district as tax-exempt when it should have been treated as taxable, which improperly limited the amount of incremental revenue for debt service and reduced the amount available to the Education Fund; and
- 4) Did not seek the Vermont Economic Progress Council's (VEPC) approval as required by statute for significant departures from the VEPC-approved TIF district plan prior to this audit's finding that approval should have been obtained.

We also note that neither statute nor rules address whether paying for costs on behalf of a private development are eligible to be financed with TIF district debt. VEPC touched on this issue in response to a 2018 Joint Fiscal Office report of the TIF program by noting that best practice is “requiring TIF be used for public infrastructure (preventing the use of it for mere revenue generation or sending benefits directly to companies or developers)...”¹ Due to a lack of clarity, we recommend that VEPC amend the TIF Rules to address whether these types of costs for private development are eligible to be financed with TIF district debt. In my opinion, VEPC should seek guidance from the legislature on this matter.

In comments to the draft audit report, the St. Albans City Manager accused the SAO of having a policy objective to discredit the TIF program. He is mistaken. The SAO has no policy objective about the TIF program. The SAO’s Chief Auditor and SAO audit staff conducted the audit in accordance with generally accepted government auditing standards. Our independence and use of these standards undergo a rigorous peer review. In the 2018 peer review, we received the highest attainable rating.

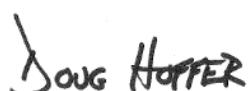
We also received a complaint from VEPC, which opined that the title of the audit report is negative and asserted this negativity is contrary to SAO core values. First, the report title reflects the audit findings and conclusions. Second, our audit findings are not based on public perception of negativity or positivity; they are based on facts, and this is consistent with our professional standards. VEPC’s concern about public perception of evidence-based findings explaining a city’s non-compliance with a program the Council is required by statute and rules to oversee and monitor raises questions for me about VEPC’s objectivity and independence in executing those duties.

Additionally, we identified matters pertinent to the City’s procurement and contracting practices and include these in a separate section called Other Matters. Our audit focused on the eligibility of costs under the TIF district statute and TIF Rules, and we did not review St. Albans’ processes and procedures for contracting in general. As a result, we are not making any recommendations, but we believe these matters warrant the attention of city government.

This report is available on the state auditor’s website: <http://auditor.vermont.gov/>.

I would like to acknowledge the staff and management at the City of St Albans for their cooperation in providing information and assistance during the audit.

Sincerely,



DOUGLAS R. HOFFER
State Auditor

¹ “An Examination of the State of Vermont Tax Increment Financing Program,” JFO, Jan. 24, 2018.

ADDRESSEES

The Honorable Mitzi Johnson
Speaker of the House of Representatives

The Honorable Phil Scott
Governor

Mr. Adam Greshin
Commissioner, Department of Finance and Management

Megan Sullivan
Executive Director, Vermont Economic Progress Council

The Honorable Tim Ashe
President Pro Tempore of the Senate

Ms. Susanne Young
Secretary, Agency of Administration

Dominic Cloud
City Manager, City of St. Albans

John Davis
Chair, Vermont Economic Progress Council

Contents

	Page
Introduction	6
Highlights	8
Background	12
Objective 1: TIF Financed Eligible Infrastructure Improvement Costs and Related Costs but also Funded Unauthorized Uses	16
Objective 2: Insufficient Amount of Tax Increment Retained for TIF District and Education Increment Owed to Education Fund	32
Objective 3: FY2017 TIF District Debt Payments an Eligible Use of Tax Increment	36
Other Matters	38
Conclusions	41
Matters for Legislative Consideration	42
Recommendations to Management	42
Management's Comments	45
Recommendations to VEPC	45
VEPC's Comments	46
Appendix I: Scope and Methodology	47
Appendix II: Abbreviations	50
Appendix III: Improvements Approved by VEPC August 2012	51
Appendix IV: Estimate of Tax Increment and Amount Owed	53

Appendix V: AGO Memos	54
Appendix VI: Comments from Management	70
Appendix VII: SAO Evaluation of Management's Comments	77
Appendix VIII: Comments from VEPC	91
Appendix IX: SAO Evaluation of VEPC Comments	97

Introduction

Tax increment financing (TIF) is a tool that municipalities use to finance public infrastructure improvements, such as: streets, sidewalks and storm water management systems. In Vermont, establishment of a TIF district allows a municipality to designate an area for improvement, incur debt to finance infrastructure improvements, and earmark a portion of expected future growth in property tax revenues (called incremental property tax revenue) to repay the debt. The incremental property tax revenue is comprised of municipal tax increment and statewide education tax increment.

According to a report by the legislative Joint Fiscal Office, Vermont's TIF program will cost the state Education Fund approximately \$68 million (nominal dollars) from 2017 to 2030.² This same report indicates that a large portion of TIF district financing is borne by municipalities without TIF districts and concludes that TIF involves considerable uncertainty, including the risk that municipalities could borrow money using inaccurate growth projections that fall short, putting pressure on municipal budgets. If tax increment falls short of projections, municipalities will be forced to repay the debt through other resources in their budgets.

The Vermont Economic Progress Council (VEPC) is charged with approving and overseeing Vermont's TIF program. According to VEPC's 2018 Annual Report on TIF districts, active TIF districts generated about \$55.6 million in incremental property tax revenue through fiscal year 2017.³ Of this amount, approximately \$34.3 million of education increment and \$16.6 million of municipal increment has gone to finance TIF district infrastructure and \$4.7 million has gone to taxing authorities (\$2.5 million to the State, which goes to the Education Fund, and \$2.2 million to municipalities).

On August 30, 2012, VEPC approved the City of St Albans (City) TIF District Plan/TIF District Financing Plan (hereafter referred to as the TIF District Plan). VEPC authorized the City to use approximately \$23 million of incremental property tax revenues to finance infrastructure improvements for the TIF district projects outlined in the TIF District Plan and \$10.6 million for interest costs on debt.

² "An Examination of the State of Vermont Tax Increment Financing Program," Vermont Legislative Joint Fiscal Office, January 24, 2018. <https://lifo.vermont.gov/assets/docs/reports/79f1f110da/Final-TIF-Report-January-24-2018.pdf>

³ "2018 Annual Report July 1, 2016 – June 30, 2017 Tax Increment Financing Districts," Vermont Economic Progress Council. <https://accd.vermont.gov/sites/accdnew/files/documents/DED/VEPC/Tiff/AnnualReports/Final-2018-TIF-AnnualReport.pdf>

32 V.S.A. §5404a(l) requires the State Auditor's Office (SAO) to conduct audits of all TIF districts according to a schedule, arrived at in consultation with VEPC, and that includes a validation of the portion of the tax increment retained by the municipality. Our objectives for this audit were to assess whether 1) TIF district debt financed eligible improvements and related costs in fiscal years (FY) 2016 and 2017; 2) the City retained the appropriate amount of education and municipal tax increment in FY2017; and 3) tax increment was utilized in FY2017 for eligible purposes.

Appendix I contains detail on our scope and methodology. Appendix II contains a list of abbreviations used in this report.

Highlights

32 V.S.A. 5404a(l) requires the SAO to audit certain aspects of municipal TIF district activities. Our objectives for the St Albans City Downtown TIF District audit were to assess whether 1) TIF district debt financed eligible improvements and related costs in FY2016 and FY2017; 2) the City retained the appropriate amount of education and municipal tax increment in FY2017; and 3) tax increment was utilized in FY2017 for eligible purposes.

Objective 1 Finding

The City used TIF district debt to finance \$752,872 and \$756,410 of costs in FY2016 and FY2017, respectively. SAO reviewed most of these costs and found that \$631,405 and \$315,871 was used for eligible infrastructure improvements (improvements) and related costs in FY2016 and FY2017, respectively. However, the City also used \$119,331 in FY2016 and \$434,361 in FY2017 primarily for costs associated with the development of a privately-owned hotel, and SAO questioned whether the costs were eligible to be financed with TIF district debt. In consultation with the Attorney General's Office (AGO), SAO also identified: (1) use of TIF district debt in 2013 and 2014 for an improvement that was not in the 2012 VEPC-approved TIF District Plan and other changes to the TIF District Plan that the City should have submitted to VEPC for approval; and (2) inappropriate use of TIF debt proceeds to pay for TIF district debt service (principal and interest).⁴ These issues pertain to FY2017, FY2016, and earlier years.

Use of TIF district debt for costs not within the scope of VEPC-approved improvements and changes to the VEPC-approved TIF District Plan

- For \$553,692 of costs financed with TIF district debt that were primarily for a private hotel development, the City asserted the costs were part of the VEPC-approved core brownfield improvement or were related costs directly related to the implementation of the TIF District Plan as approved by VEPC. SAO concluded that \$426,559 was outside the scope of core brownfield because the costs were not brownfield remediation activities described in the VEPC-approved TIF District Plan and as a result should not have been financed with TIF district debt. For another \$118,125 (\$100,000 for a real estate brokerage fee and \$18,125 for other professional services), the costs were associated with a private hotel development or other private development projects in the TIF district. Statute and the TIF Rules⁵ do not explicitly address whether costs associated with private development projects may be financed with TIF district debt, so it is not clear whether the

⁴ See Appendix V for AGO memos.

⁵ TIF Adopted Rule, Rule #15-P04, <https://accd.vermont.gov/sites/accdnew/files/documents/DED/VEPC/Tiff/TIFAdoptedRule05062015.pdf>

costs associated with the hotel development are considered either improvements or related costs.

- In FY2013 and FY2014, \$1,737,380 of costs financed with TIF district debt were for a project known as ACE Hardware that was not in the VEPC-approved TIF District Plan but had been approved by St Albans City voters. The City consulted with the then-VEPC Executive Director regarding the ACE Hardware project. The VEPC Executive Director determined that the City could conduct brownfield remediation anywhere in the district without requiring an amendment to the TIF District Plan since the original plan included brownfield projects. According to the current VEPC Executive Director, this decision was consistent with the VPEC 2012 Substantial Change Policy in effect at that time.
- Total costs for the core brownfield and parking garage improvements and related costs exceeded the VEPC-approved estimated amount to be financed with TIF district debt by \$4,969,994 (56 percent).
- Since opening the TIF district parking garage in October 2014, the City failed to use parking fees of \$254,792 to finance the TIF district debt. This is contrary to the TIF District Plan, which stated that the revenues would be used for this purpose, and contrary to the requirement in TIF Rule 911 to use income generated by infrastructure financed with tax increment in accordance with the district authorization document issued by VEPC.
- According to guidance from the AGO, the City's changes to its 2012 VEPC-approved TIF District Plan constitute a substantial change per statute and the TIF rules, and they should have been submitted to VEPC for review.

Use of TIF district debt to pay for TIF district debt service

- According to the audited financial statements, from FY2013-2017, the City used \$911,803 of the \$16 million borrowed to make payments (principal and interest) on this debt. The City Manager indicated that another \$83,054 was used in FY2018 for payments, and he anticipated that approximately \$40,000 would be used in FY2019.
- This use of TIF district debt was not included in the TIF District Plan approved by VEPC. Furthermore, according to guidance from the AGO, using TIF district debt proceeds to pay debt service on TIF district debt is not allowed under the TIF statutes.

Because the issue of VEPC approval for changes to the 2012 TIF District Plan was raised during the audit, the City submitted a substantial change request to VEPC in January 2019 which VEPC approved February 28, 2019. As a condition of approving the revised financing plan and substantial change request submitted by the City in January 2019, VEPC required that the City repay the amount of borrowed funds used for debt service and utilize the funds for future projects.

Objective 2 Finding

The City calculated the FY2017 tax increment as \$1,038,800 and retained \$779,620. However, these amounts are understated because the City treated a city-owned parking garage (opened October 2014 in the TIF district) as tax-exempt, excluding it from the calculation of tax increment. The City's legal counsel supported the City's treatment of the garage as tax-exempt, but the AGO advised SAO that the parking garage is taxable. The AGO pointed out that the Legislature chose not to enact proposed amendments to 32 V.S.A. §5401(10)(F) in 2015 and 2016 that would have explicitly excluded municipally-owned parking garages from property taxes. The AGO indicated that if the Legislature had intended to exempt these properties, it would have enacted the proposed language.

Using the value of the parking garage per city-certified property valuation records submitted to the Property Valuation and Review (PVR) division of the Vermont Department of Taxes (VDT), SAO estimates the education tax increment and municipal tax increment were understated by \$148,061 and \$84,814, respectively, in FY2017. Cumulatively, from FY2016 to FY2018, SAO estimates the City understated the education tax increment by \$447,547 and the municipal tax increment by \$252,244. Based on this estimate, the City owes the state Education Fund \$111,886 (25 percent of education tax increment) and the TIF district \$524,844 (75 percent of both education and municipal tax increment⁶).

City officials asserted that the value in the property records is not based on any formal methodology or is based on an inconsequential analysis. The City Manager indicated the City will obtain an independent appraisal and work with PVR to determine, what, if anything, should be paid. The City believes there may be an opportunity to address inaccuracies such as may occur during a tax appeal or negotiated settlement process. According to PVR, any adjustment in the valuation of the parking garage would be part of the City's inventory on April 1, 2019 and take effect in grand list 2019.

Regardless of the value determined by the appraiser and whether adjustments to values in the property records previously submitted to PVR are allowed, the City owes the state Education Fund 25 percent of the education tax increment and the TIF district 75 percent of the education and municipal tax increments for the periods that the value of the parking garage was omitted from the calculation.

Objective 3 Finding

In FY2017, incremental tax revenue of \$779,620 was used for payment of TIF district debt. This is an eligible use - per 24 V.S.A. §1894(1), 24 V.S.A. §1896(d),

⁶ 24 V.S.A. §1894(b) and (c)

and TIF Rule 714 - so long as the appropriate approvals for the debt are obtained, and the debt is issued within the allowed borrowing period.

The City obtained requisite approvals, including municipal voter approval, disclosing all required information prior to the public vote to approve a \$3 million bond in March 2013. The City complied with most disclosure requirements for a \$13 million bond vote held in September 2013, except for disclosing interest and fees and the term of the debt. Although the City did not disclose these specifics, the City presented a range for annual debt payments, including interest, during public meetings held prior to the vote. The City Manager believes that the term of the debt was disclosed during the public meetings, but the City's presentation materials and the minutes for the meetings do not reflect that the term was disclosed. As a result, it is not clear if voters understood the full estimated cost of the bond.

This deficiency may have occurred because the statutory requirements for information to be provided prior to a public vote changed substantially effective April 1, 2013.

In May 2015, the TIF rules were issued and Rule 1003.2.2 clarified that an informational notice must be provided to voters, and the rule detailed the information required to be included, such as interest, fees and terms of debt. The rules also stated that public information notices must be provided to VEPC in advance of the public vote. In addition, VEPC staff provided a checklist to municipalities with TIF districts which is used by VEPC to review the disclosures made in advance of public votes. The clarified guidance in the TIF rules, requirement to provide the public information notice to VEPC, and the VEPC checklist may result in improved future disclosures to the voters.

Other Matters

SAO identified other matters during the audit that were relevant to the City's procurement and contracting. These are discussed in the section Other Matters.

Recommendations

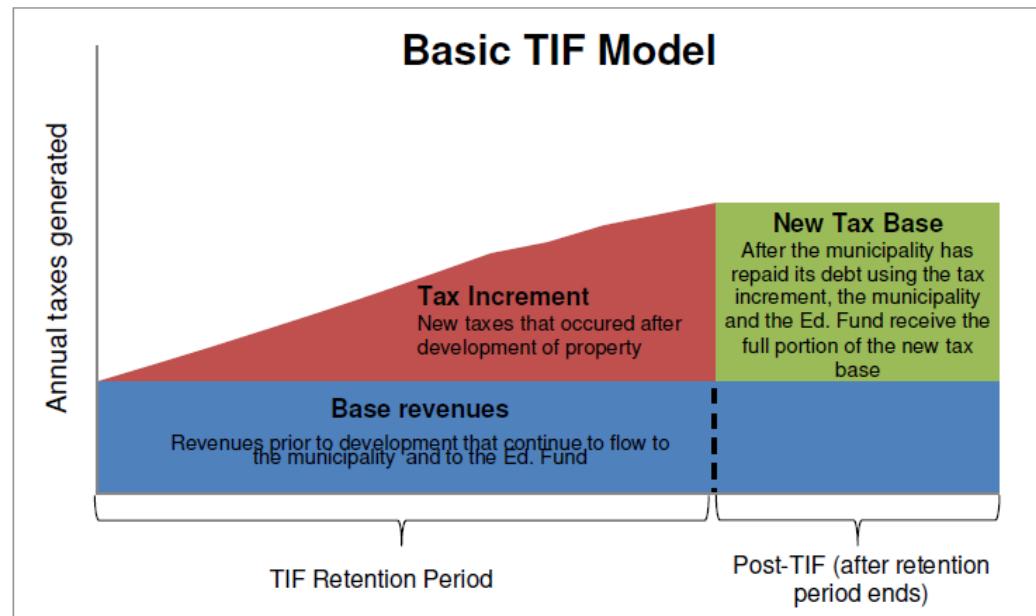
SAO made numerous recommendations to the City related to compliance with TIF district statutory and rule requirements. SAO also made recommendations to VEPC that included amending the TIF rules to clarify aspects of TIF requirements. SAO has one recommendation for consideration of the Legislature to clarify in statute whether related costs may be financed with TIF district debt.

Background

The purpose of a TIF is to fund public infrastructure and stimulate economic development. A municipality designates a geographical area where it wants to encourage private sector development, and where the municipality thinks public infrastructure improvements are needed for that development. The municipality incurs debt to finance the needed public infrastructure improvements in the TIF, which in theory, stimulates private investment that would not otherwise have occurred in the designated TIF area. The combination of both public and private investment is expected to increase property values, generating property tax revenue. The expected growth in property tax revenues (i.e., incremental property tax revenue) in the designated area is used to pay debt incurred to finance the cost of improvements. The tax increment, comprised of education and municipal increment, is retained by the municipality for a maximum period of 20 years beginning the year in which the first debt obligation is incurred. Taxing authorities, like the municipality and the State, continue to receive property tax revenue on the original taxable value (OTV) of the properties during this time.

Figure 1 below shows the basic TIF model, including the anticipated tax increment.

Figure 1: Basic TIF Model^a



^a Source: An Examination of the State of Vermont Tax Increment Financing Program, January 24, 2018, Vermont Legislative Joint Fiscal Office

TIF District Authorization and Oversight

The Vermont legislature designated VEPC as the state body responsible for approving a TIF district.⁷ VEPC must authorize a municipality to utilize incremental education property tax to finance TIF district improvements.⁸

Since 2006, a municipality desiring to utilize incremental education property tax to finance TIF district improvements must file an application with VEPC. The application must contain both a district plan that has received prior approval from the municipal legislative body, and a district finance plan. The district finance plan, which includes plans for debt financing, must be approved by VEPC before the municipality seeks a public vote to pledge the credit of the municipality (i.e., issue debt). Prior to seeking VEPC approval, a municipality must have held public hearings and established a tax increment financing district.

According to statute, VEPC conducts oversight and non-compliance enforcement of all districts. On May 6, 2015, VEPC adopted rules as required by statute⁹ to address issues related to creating, implementing, administering, and operating TIF districts. The TIF District Adopted Rules (TIF Rules) address VEPC's oversight and monitoring of the TIF districts' compliance with rule and statute, and enforcement of any aspects of non-compliance and resolution.

TIF District Debt and Tax Increment

After VEPC approves the use of incremental education property tax to finance TIF district improvements, the municipality must seek voter approval to incur debt to build public infrastructure improvements and pay for related costs.

Improvements means the installation, new construction, or reconstruction of infrastructure that will serve a public purpose and fulfill the purpose of the district.¹⁰ According to TIF Rule 704, improvements may include, but are not limited to: transportation (e.g., public roads, parking lots, garages, streetscapes, and sidewalks), land and property acquisition, property demolition, site preparation, and utilities, such as wastewater, storm water, water dispersal and collection systems.

Related costs are defined as expenses incurred and paid by the municipality, exclusive of the actual cost of constructing and financing improvements, that

⁷ 32 V.S.A. § 3325(a)(2) and 32 V.S.A. § 5404a(f)

⁸ 32 V.S.A. § 5404a(f)

⁹ 32 V.S.A. § 5404a(j)

¹⁰ 24 V.S.A. § 1891(4)

are directly related to the creation and implementation of the TIF district.¹¹ TIF Rule 705 provides examples of related costs and indicates that related costs are not limited to these examples. The following are some examples: (1) professional services incurred during preparation of a district plan, district finance plan, district application, or substantial change request, (2) costs of providing public notification about, and obtaining public approval for, a district plan, district finance plan, application or filing with VEPC, and (3) consulting, design, architects, engineering and other similar professional services costs directly related to the implementation and construction of eligible TIF district improvements.

Tax increment may be used to pay TIF district debt and to directly pay for improvements and related costs.

Incremental property tax revenue is required by statute to be calculated as incremental property value growth (total current April 1 assessed value of taxable TIF district properties less OTV¹²) multiplied by the municipal and statewide education property tax rates (i.e., tax rates of all taxing authorities).

St. Albans Downtown TIF District

St. Albans established the St. Albans City Downtown TIF District in 2012.

VEPC issued the Final Determinations, Exclusions, Conditions and Obligations (Final Determination), dated August 30, 2012, approving the City's TIF District Plan and TIF district financing plan (hereafter referred to as the TIF District Plan). Pursuant to that Final Determination, the City was authorized to utilize up to 75 percent of the education tax increment. Statute requires that at least an equal portion of the municipal tax increment is retained to finance public infrastructure debt incurred for the TIF district.¹³

The planned infrastructure improvements were city park improvements, structured parking, a storm water separation and treatment project, brownfield remediation (two sites - Core and Fonda), and various transportation improvements including a multi-modal corridor to improve traffic flow, streetscape and wayfinding improvements, street reconstruction, new sidewalks, and street lighting. See Appendix III for descriptions of the VEPC approved improvements and costs anticipated to be financed with TIF district debt.

¹¹ 24 V.S.A. § 1891(6)

¹² 24 V.S.A. § 1891(5) defines OTV as the total valuation as determined in accordance with 32 V.S.A. Chapter 129 of all taxable real property located within the TIF district as of the creation date as set forth in section 1892 of this subchapter, provided that no parcel within the district shall be divided or bisected by the district boundary.

¹³ 32 V.S.A. §1894(c)

St. Albans Accounting for TIF District Projects and Financing

The City has used the following four funds to record activity associated with the TIF district:

1. **TIF Capital Projects Fund:** Records and tracks all projects and initiatives within the TIF district that are funded with TIF debt proceeds. Debt proceeds are recorded in the fund. The City transfers resources from the Water Fund and Wastewater Fund to the TIF Capital Projects Fund to fund capital improvements.
2. **TIF Debt Service Fund:** Accounts for debt service (payment of principal and interest) on voter approved TIF bonds and incremental property tax revenues. The debt service payments are funded by incremental property tax revenues in the TIF district and contributions from the TIF Capital Projects Fund and other City funds such as the General Fund (main operating fund).
3. **Streetscape Fund:** Accounts for all expenditures, revenues, and grants related to downtown streetscape projects. The City has transferred resources from the TIF Capital Projects Fund into the Streetscape Fund to cover costs for the streetscape improvement.
4. **Federal Street Bypass Fund:** Accounts for all expenditures, revenues, and grants related to the construction of the Federal Street Bypass. In FY17, the City transferred resources from the TIF Capital Projects Fund into the Federal Street Bypass Fund to cover costs for the Federal Street multi-modal improvement.

Objective 1: TIF Financed Eligible Infrastructure Improvement Costs and Related Costs but also Funded Unauthorized Uses

The City used TIF district debt of \$631,405 and \$315,871 in FY2016 and FY2017, respectively, to finance eligible infrastructure improvements (improvements) and related costs. However, the City used \$119,331 in FY2016 and \$434,361 in FY2017 primarily for costs associated with the development of a privately-owned hotel, and SAO questioned whether the costs were eligible to be financed with TIF district debt. The City asserted that some of the costs were part of the core brownfield improvement or were related costs directly related to the implementation of the TIF District Plan as approved by VEPC. SAO concluded that \$426,559 of hotel costs were not for the brownfield remediation activities described in the improvement approved by VEPC and should not have been financed with TIF district debt. In addition, statute and the TIF Rule do not explicitly address whether costs associated with private development projects may be financed with TIF district debt, so it is not clear that these costs are considered infrastructure improvements or related costs.

SAO also found that the City used \$1,737,380 of TIF district debt in previous years for ACE Hardware , which was not an improvement in the 2012 TIF District Plan approved by VEPC, incurred higher costs than anticipated for improvements in the VEPC-approved TIF District Plan, and failed to use parking garage revenues to finance the TIF district as required by the VEPC-approved TIF District Plan and the TIF rules. Upon consultation with the AGO, the differences between the City's implementation of the TIF district and the VEPC-approved TIF District Plan were determined to be a substantial change to the VEPC-approved TIF District Plan, required by statute and TIF rules to be submitted to and approved by VEPC.

The City also used TIF district debt proceeds of \$192,639 and \$162,456 in FY2016 and FY2017, respectively, and approximately \$1,000,000 cumulatively, for debt service on the TIF district debt, rather than for infrastructure improvements as approved by VEPC. The AGO advised that using TIF district debt to pay debt service was not allowed under TIF statutes.

The City Manager believes that the VEPC-approved TIF District Plan is the broad authorization of categories, but the voter-approved projects are the specifics so the TIF District Plan is an authorization, but not an obligation. City staff did consult about ACE Hardware in 2013 with the then-VEPC

Executive Director who determined that submission of a substantial change request was not required. He reasoned that it was for brownfield remediation consistent with other improvements in the VEPC-approved TIF District Plan.

At the request of VEPC, the City provided the council with an updated financing plan for the TIF district in January 2019. As a result of the audit, the City also submitted a substantial change request to VEPC, requesting approval of the revised financing plan. The request did not address the costs associated with the privately-owned hotel that the City financed with TIF district debt, but it did address other changes from the original TIF District Plan noted in this audit report. The City at this time also reported its use of TIF debt proceeds to pay for TIF district debt service. On February 28, 2019, VEPC approved the City's substantial change request with the following conditions: (1) the total amount of debt the City could incur was reduced from \$23 million to \$21 million; (2) the City would repay the working capital reserve¹⁴ the amounts used to pay debt service and use those funds for future voter approved TIF improvements; and, (3) the City would apply 100 percent of the municipal tax increment to the TIF debt repayments.

Costs Financed with TIF District Debt in FY2016 and FY2017

VEPC approved St. Albans' TIF District Plan in 2012, authorizing TIF district financing to pay for the improvements and related costs as described in the City's plans.¹⁵ Subsequently, city voters approved \$16 million of debt issuances for specific improvements, including a parking garage, the Federal Street multi-modal improvement (Federal Street), streetscape, brownfields, and for related costs.

The City used TIF district debt to finance \$752,872 and \$756,410 of costs in FY2016 and FY2017, respectively. The City provided invoices, contracts, and other evidence, which substantiated that most of the costs in FY2016 and some of the costs in FY2017 were related to core brownfield, streetscape, or Federal Street, and were improvements or related costs as defined by statute.

The remaining costs largely related to the development of a privately-owned hotel, including a brokerage fee paid to a real estate advisor in connection with the sale of a city-owned property to the hotel developer; site preparation such as bearing soils needed for the hotel; utility line connections; and construction of a handicap ramp and stairs from the City's parking garage to the hotel. These costs were categorized as hotel-brownfield or hotel-other in the City's internal records. The City asserted the brokerage

¹⁴ According to the audited financial statements from FY2013 to FY2017 debt proceeds from TIF district debt issuances were used to pay debt service (principal and interest) on TIF district bonds.

¹⁵ See Appendix III for information about the improvements and related costs.

fee was an eligible related cost, and the remainder was for the VEPC-approved core brownfield improvement. Based on information in the City's TIF district application and VEPC's Final Determination, SAO concluded that core brownfield as approved by VEPC was limited to brownfield remediation activities and most of the hotel-related costs were not brownfield remediation activities.

See Table 1 for the results of SAO testing of the costs financed by TIF district debt in FY2016 and FY2017. The category "questionable eligibility" includes costs that are not in the scope of a VEPC-approved TIF infrastructure improvement, costs not explicitly addressed in statute or the TIF Rule as eligible, or costs for which, based on the evidence provided, we could not tell if the costs relate to a VEPC-approved infrastructure improvement or qualify as a related cost.

Table 1: Eligible costs and Costs of Questionable Eligibility in FY2016 and FY2017

Description of TIF Expenses^a	FY2016			FY2017		
	Total costs tested	Eligible costs	Questionable eligibility^b	Total costs tested	Eligible costs	Questionable eligibility^b
Construction, Garage and Site	\$267,883	\$267,883 ^c	\$0	N/A	N/A	N/A
Professional Services, Financing, and Soft Costs	\$20,663	\$5,297	\$15,366	\$14,009	\$6,685	\$7,324
Hotel Brownfield	\$67,528	\$63,563 ^c	\$3,965	\$337,418	\$10,381 ^d	\$327,037
Hotel Other	\$100,000	\$0	\$100,000	\$100,000	\$0	\$100,000
Streetscape	\$294,662	\$294,662	\$0	\$106,306	\$106,306	\$0
Federal Street	\$0	\$0	\$0	\$192,499	\$192,499	\$0
TOTAL	\$750,736	\$631,405	\$119,331	\$750,232	\$315,871	\$434,361
Percentage of total costs tested		84%	16%		42%	58%

^a Per the Summary of TIF Expenses, an Excel ® spreadsheet used by the City to track use of TIF district debt and TIF district costs.

^b Questionable eligibility includes costs that are not in the scope of a VEPC-approved infrastructure improvement, costs not explicitly addressed in statute or the TIF Rule as eligible, and \$8,530 in FY2016 and \$478 in FY2017 for which, based on the evidence provided, we could not tell if the costs relate to a VEPC-approved infrastructure improvement or qualify as a related cost.

^c SAO concluded that these costs were for the VEPC-approved core brownfield improvement, with the exception of \$1,802 which relates to the VEPC-approved streetscape improvement.

^d SAO concluded that these costs were for the VEPC-approved streetscape improvement.

Eligible infrastructure improvements and related costs

Infrastructure improvement costs are eligible for TIF district financing if (1) the improvement is included in a TIF District Plan approved by VEPC,¹⁶ (2) municipal voters approve debt issuances to finance the improvement,¹⁷ and (3) the improvements conform to the definitions established in statute¹⁸ and the TIF Rules.¹⁹ Substantial changes to a VEPC-approved TIF District Plan require VEPC's review and approval and minor changes or corrections must be reported.²⁰

The statutes are less than clear but should be read to allow TIF debt to be used to finance related costs according to guidance from the AGO.²¹ The AGO noted that the definition of financing in 24 V.S.A. §1891(7) suggests that TIF debt should be used to finance improvements only, and not related costs. However, TIF financing plans are subject to approval by VEPC and the statute governing the VEPC approval process contemplates "financing of the improvements and related costs."²² Further, TIF Rule 705 assumes that TIF debt may be used to pay related costs.

The following describes the improvements and related costs that SAO concluded were eligible to be financed with TIF district debt.

Core brownfield: In FY2016, the City engaged a contractor to transport contaminated soils from the core brownfield site to a city location, and subsequently on to a final location in New York. The City also incurred costs from the disposal site in New York for accepting the contaminated soils. The City categorized these costs in its internal records as garage or hotel brownfield, but SAO concluded the costs were for the VEPC-approved core brownfield improvement.

Streetscape: In FY2016 and FY2017, a City contractor performed work on part of the Lake Street Complete Streets for the section of Lake Street between Main Street and Federal Street, and enhancements from Hudson to Hoyt Streets.

Related costs: In FY2016, related costs were for legal and environmental consulting services pertaining to core brownfield. In FY2017, related costs were for design work connected to streetscape and advice generally

¹⁶ 24 V.S.A. § 1894 (a)(1) and (d)

¹⁷ 24 V.S.A. § 1894 (h) and 24 V.S.A. §1891(7)

¹⁸ 24 V.S.A. § 1891 (4) and (6)

¹⁹ TIF Rules 300, 704, and 705

²⁰ TIF Rule 607 and 24 V.S.A. §1901(B)

²¹ See Appendix V for AGO memos.

²² 32 V.S.A. §5404a(f)

pertaining to TIF financing and debt capacity. The City categorized these costs as professional services, financing and soft costs in its internal records and SAO concluded these costs were related costs.

Federal Street: In FY2017, a city contractor performed work on the intersection of Federal and Lake Streets including reconstruction of Market Street, new curbing and sidewalks, utility infrastructure improvements, and streetscape lighting and landscaping.

Questionable Eligibility of Costs

For FY2016 and FY2017, SAO found that the City used \$553,692²³ of TIF district debt to finance costs primarily associated with the development of a privately-owned hotel. Of this amount, the City classified \$531,002 as “hotel-brownfield” or “hotel-other” in its Summary of TIF Expenses (city spreadsheet used to track TIF costs and the use of TIF debt proceeds, hereinafter referred to as the tracking tool) and the City advised SAO that \$431,002 was for the core brownfield improvement approved by VEPC and \$100,000 was related costs. Another \$22,690 was classified as professional services, financing, and soft costs in the City’s tracking tool and the City subsequently advised SAO \$18,125 of these were related costs.²⁴

The City’s TIF application materials described the core brownfield improvement as mitigation of brownfield conditions.²⁵ Further, the VEPC Final Determination indicated that the core brownfield improvement was based on an environmental site investigation report that identified the presence of polycyclic aromatic hydrocarbons and heavy metals in the soil and two potential environmentally hazardous underground storage tanks in the area. The report indicated that the core brownfield conditions must be mitigated before development may occur. Subsequently, a corrective action plan report was developed to remediate parcels that formed the core brownfield site.²⁶ The corrective action plan contained goals to manage contaminants to prevent unacceptable risk to human health and the environment and recommended a remedial approach for achieving the goals.

In 2015 municipal voters approved the use of TIF district debt for brownfield clean-up at the hotel development site on Lake Street. The warning and other documentary evidence provided by the City or available on the City’s website does not indicate that voters were explicitly informed that the brownfield

²³ This amount is the sum of questionable eligibility column for FY2016 and FY2017 in Table 1.

²⁴ The City advised SAO that the remaining \$4,565 was for core brownfield remediation but did not provide sufficient evidence for SAO to determine if the costs relate to a VEPC-approved improvement project or qualify as related costs.

²⁵ Brownfields pose a real or potential threat to human health and the environment according to The Vermont Brownfields Handbook: A Guide to Navigating Brownfield Redevelopment Projects, prepared by the Vermont Department of Environmental Conservation.

²⁶ Corrective Action Plan Downtown Core Project St Albans, VT, prepared by Environmental Compliance Services, Inc, September 27, 2013.

clean-up at the hotel would include costs such as a real estate brokerage fee and site improvements for the benefit of the hotel.

SAO concluded that invoices, contracts, and an amendment to the City's purchase and sale agreement with the hotel developer show that costs the City incurred for the development of the privately-owned hotel were not included in the core brownfield improvement approved by VEPC or the brownfield clean-up at the hotel development site approved by voters in 2015. As a result, SAO concluded that \$426,559²⁷ of hotel costs in FY2017 were not for the brownfield remediation activities described in the core brownfield improvement approved by VEPC and should not have been financed with TIF district debt.

The following describes the costs associated with the development of the privately-owned hotel:

- **Brokerage fee** – In FY2016, the City paid its real estate investment advisers a flat fee of \$100,000 for services associated with an exclusive right to market agreement. The full fee was paid to the advisers by the City on the completion of the sale of the city-owned property at 43 Lake Street to the hotel developer.²⁸
- **Other improvements:** The City committed to paying \$250,000 to the hotel developer for specific works identified as 'other improvements' for the benefit of the hotel in an amendment to the purchase and sale agreement for the property. The other improvements included installing underground service lines connecting the hotel to city utility lines, installing a handicap ramp and stairs from the City's parking garage directly to the hotel property, performing streetscape works within the alleys adjacent to the hotel property and costs for the developer's insurance, profit and overhead and construction manager's fees. According to the description in the amendment, there were also some landscaping improvements along the Lake Street right of way. These may overlap with the City's streetscape improvement approved by VEPC, but the City has not provided evidence that shows the value of this work. The general invoices and application and certificate submitted by the developer for payment in FY2017 did not provide details of the work

²⁷ The City classified \$3,965 and \$478 as Hotel Brownfield in the tracking tool in FY2016 and FY2017, respectively, but based on the evidence provided by the City, we could not tell if the costs relate to a VEPC-approved infrastructure improvement or qualify as a related cost.

²⁸ The City executed a purchase and sale agreement with the developer and sold the property at 43 Lake Street for \$1.00 and executed a separate agreement with the developer for the City to invest \$1 million in the hotel project.

performed for the \$250,000 or include a schedule of detailed costs for the work performed.

- **Site preparation and foundation costs:** The amendment to the purchase and sale agreement also obligated the City to pay for removal of soils not suitable for bearing within the footprint of the hotel building and replace with suitable soils. In FY2017, the hotel developer issued an invoice to the City for \$186,940 for costs associated with the hotel. Of the total invoice value, SAO determined that \$10,381 of costs for removing urban fill and existing concrete were eligible costs for the VEPC approved core brownfield improvement, but the remainder was for costs not related to this improvement. The invoice was broken into item numbers, with the majority of costs for the building foundation (\$122,133). Detailed descriptions in the invoice described work including excavation of unsuitable bearing material and backfill with graded structural fill; prep work for the elevator pad with sump; excavate and prep for footings, over excavate to allow for stone under the footings; dug for footing and interior walls (stairwells).

The City contends that the \$100,000 brokerage fee paid to the real estate consultant is an eligible related cost because the City's [2012] TIF District Plan anticipated the hotel would be one of the real property private developments in the TIF District Plan approved by VEPC and therefore the brokerage fee meets the definition for related costs as it is "directly related to the creation, implementation, administration, and operation of a TIF district."²⁹ This definition doesn't explicitly address whether costs associated with a private development project qualify as related costs. TIF rule 705 provides various examples of related costs, including, but not limited to, soft costs such as consulting, design, legal, project management or other professional services directly related to the implementation and construction of eligible district improvements. The rule does not provide an example of costs paid by municipalities for private development projects that qualify as a related cost, but the rule does specify that related costs do not include any cost incurred by private entities undertaking development or redevelopment within a district. Because costs associated with a private development project are not explicitly addressed in statute or TIF Rules, it is not clear that these costs are considered related costs.

The City has asserted that it was always under the impression that the costs for the hotel were part of the core brownfield improvement and are therefore

²⁹ This definition is in TIF Rule 300 which expands the statutory definition which states "directly related to the creation and implementation of a TIF district."

authorized based on the statutory definition of improvements. 24 V.S.A. §1891(4) indicates that site preparation is considered an improvement eligible for TIF financing and TIF rule 704 indicates that site preparation - such as acquisition, demolition, and environmental remediation - are eligible improvements, but neither statute nor the rules address whether paying for site preparation and other costs on behalf of a specific private development project are eligible improvement costs that may be financed with TIF district debt. A July 2017 VEPC Frequently Asked Questions (FAQ)³⁰ document states "Vermont law only allows the tax revenue generated from within a TIF district to be used to pay for public infrastructure. The public infrastructure may assist or encourage a developer to build their project and may reduce the overall costs to the developer but the cost of the direct infrastructure a developer needs for completion of their project is borne by the developer." The FAQ example indicates that TIF financing may be used to pay for new sewer or water lines that are needed for development, but the water hook-ups and sewer connections to the main line should be paid by the developer. However, the FAQ does not define "direct infrastructure," so it is not entirely clear if the costs paid by the City are considered direct infrastructure.

Title 32 V.S.A. 5404a provides a process for municipalities to seek clarity about the administration of TIF districts, statutes, rules and noncompliance. Per 32 V.S.A. 5404a(j)(2)(A) and (B), the secretary of the Agency of Commerce and Community Development has the authority to issue decisions in response to municipalities inquiries. VEPC is required to prepare recommendations for the Secretary and as appropriate may consult with the commissioner of the Department of Taxes, the Attorney General, and the State Treasurer.

Regardless of whether the costs meet the definition of improvements, they were not included in the description of the core brownfield in the City's application materials or VEPC's Final Determination, and this work was not identified as remediation work in the corrective action plan. Further, the costs weren't described in the materials made available in advance of the public vote to authorize TIF district debt financing for brownfield clean-up at the hotel site. Therefore, SAO concluded the costs were not authorized to be financed with TIF district debt.

\$18,125³¹ of costs classified by the City as professional services, financing, and soft costs in FY2016 and FY2017, for which SAO questioned whether TIF district debt could be used, were associated with the hotel or other private development projects in the TIF district. For example, in FY2016, the costs

³⁰ Frequently Asked Questions (FAQ) Tax Increment Financing Districts in Vermont, VEPC.

³¹ Documentary evidence provided by the City for an additional \$4,565 was insufficient to determine if the costs related to a VEPC-approved improvement project or qualify as related costs.

included real estate investment advice and legal advice related to negotiating the sale of the property to the hotel developer and other agreements between the City and the hotel developer. In FY2017, the costs related to preparing a request for proposal to move a private project on Stebbins Street forward and for a private project at the junction of Main and Congress Streets. The same issue exists here as for the brokerage fee paid in connection with the sale of city-owned property; statute and the TIF Rules do not explicitly address whether costs incurred by a municipality that are associated with private development projects meet the definition of related costs.

Substantial Changes to 2012 TIF District Plan

SAO noted many differences between the 2012 TIF District Plan approved by VEPC and St. Albans' implementation of the TIF district. For example, the City used TIF district debt to finance costs that weren't included in an improvement approved by VEPC (i.e., costs associated with the private hotel development), and the costs for some VEPC-approved improvements and related costs were significantly higher than estimated in the approved plans. The financing for the district also differed from the VEPC-approved plans. Specifically, the City has not used parking garage revenues to finance the TIF district even though they committed to this in the TIF District Plan.

According to the TIF Rules, the TIF District Plan prepared by a municipality and approved by VEPC, serves as the basis for implementing the district.³² Specifically, these plans serve as the foundational documents for each district's implementation, providing the intentions of the municipality regarding debt and financing, improvements, and development / redevelopment.³³

Statute and the TIF Rules indicate that substantial changes to a VEPC-approved TIF District Plan require VEPC's review and approval.³⁴ TIF Rule 300 defines a substantial change as an amendment to an approved plan that may result in a significant impact with respect to any of the criteria specified in the TIF statutes.

Departures from VEPC-approved 2012 TIF District Plan

The City's records show that in FY2013 and FY2014 the City used \$1,737,380 of TIF district debt to finance ACE Hardware, a project located in the TIF district described as brownfield remediation, but which was not a VEPC-approved improvement. The City consulted with the then Executive Director

³² TIF Rule 607

³³ TIF Rule 1003.3.3

³⁴ TIF Rule 607 and 24 V.S.A. §1901(B)

in 2013 who determined the City could conduct brownfield remediation anywhere in the district without requiring an amendment to the TIF District Plan because the original plan included a category for brownfields. According to the current VEPC Executive Director, this decision was consistent with the VPEC 2012 Substantial Change Policy in effect at that time. The email documenting the consultation does not include the cost of ACE Hardware. In addition, the City did not provide information in the next annual report requested by the Executive Director about how it would not add costs to the overall amount of debt approved or what projects would not get financed that the Executive Director requested be included. Because of this, it is not clear the VEPC director understood the extent of the impact on the TIF district. City voters approved issuance of debt for this project.

The City also used TIF district debt in FY2016 and FY2017 for costs that the City indicated were for the core brownfield (i.e., the hotel), but SAO concluded these costs were not in the scope of the improvement approved by VEPC. Lastly, the City's records show that actual costs for the core brownfield and parking garage improvements and related costs were \$4,969,994 (56 percent) higher than the cost of the plans approved by VEPC, and there was limited or no progress for many projects.

See Table 2 for a comparison of costs per City records to VEPC-approved estimated costs for improvements the City reported to VEPC as completed and related costs.

Table 2: Comparison of Costs per City Records to Estimated Costs Approved by VEPC – Improvements Completed per City and Related Costs

Improvements Completed per City and Related Costs	Estimated TIF financed costs approved by VEPC in 2012	Actual TIF financed costs through FY2017 ^a	Costs in excess of estimate	Excess as % of estimate
Core brownfield ^b	\$56,546	\$2,889,445	(\$2,832,899)	5009%
Structured parking	\$8,767,500	\$10,197,564	(\$1,430,064)	16%
Related costs	\$35,000	\$742,031	(\$707,031)	2020%
TOTAL	\$8,859,046	\$13,829,040	(\$4,969,994)	56%

^a Source: The City's categorization of costs into VEPC-approved projects for FY2013-FY2017, prepared for purposes of the audit.

^b The City's categorization of costs includes \$1,737,380 for the Ace Hardware project and \$581,186 for costs associated with the development of a privately-owned hotel.

The City received VEPC approval in 2012 for the use of approximately \$23 million of TIF debt for seven infrastructure improvements. Significantly higher costs than estimated for two of the seven VEPC-approved

improvements and related costs, means the City has substantially less authorized TIF district debt available to accomplish the remaining five improvements.

See Table 3 for the total costs per the City's records financed with TIF district debt through FY2017 compared to the estimated TIF financed costs approved by VEPC in 2012. The costs from Table 2 are included in Table 3.

Table 3: Cumulative TIF Financed Costs Compared to VEPC-Approved Estimated TIF Financing

Category of costs	Estimated TIF financed costs approved by VEPC in 2012	Actual TIF financed costs through FY2017 ^a	(Costs in excess of estimate) TIF financing available	Status
Core Brownfield, Structured Parking, and related costs	\$8,859,046	\$13,829,040	(\$4,969,994)	Core brownfield and structured parking completed
Federal Street	\$6,512,389	\$192,499	\$6,319,890	In progress
Streetscape	\$5,261,255	\$1,134,943	\$4,126,312	In progress
Park Improvements	\$769,250	-	\$769,250	Not started
Fonda Brownfield	\$592,982	-	\$592,982	Not started
Stormwater	\$1,150,000	-	\$1,150,000	Not started
TOTALS	\$23,144,922	\$15,156,482	\$7,988,440	

^a Source: St. Albans' categorization of costs into VEPC-approved projects for FY2013-FY2017 prepared for purposes of the audit.

Table 3 shows that as of the end of FY2017, the City had \$7,988,440 of TIF financing approved by VEPC available to cover the costs of the five improvements in progress or not started. According to the estimated costs in the 2012 TIF District Plan, \$12,958,434 is needed to complete these improvements.³⁵

Subsequent to FY2017, the City commenced work on another improvement (known as Main and Congress),³⁶ which involved brownfield remediation and parking, and for which it planned to use \$2.5 million of TIF district debt. This improvement was not in the 2012 TIF District Plan approved by VEPC. In 2018 a city consultant discussed whether a substantial change should be

³⁵ Sum of the amount of TIF financing available for the improvements that are in progress or not started (Table 3).

³⁶ TIF district debt of \$2.5 million has been approved by municipal voters for Main and Congress. According to the City Manager, approximately \$1.6 million of City resources was used subsequent to FY2017 for property acquisition and professional services associated with the project.

submitted with the then-Executive Director of VEPC. The Executive Director consulted with ACCD legal counsel and indicated it was not necessary.

In total, the City has committed \$17,656,482³⁷ of the \$23,144,922 that VEPC approved for improvements and related costs to be financed with TIF district debt.

Change to TIF Financing

In its TIF District Plan, the City estimated that over the 20-year period anticipated for TIF district debt repayment, \$2.4 million of parking garage fee revenue would be generated from the planned TIF district parking garage and represented that the revenues would be used as part of financing the district. Contrary to this representation, according to FY2013 to FY2017 audited financial statements, no parking garage revenue was recorded in either of the funds used to account for TIF district activity, but the City's FY2020 parking program budget shows that the parking garage generated fees of \$254,792 through FY2018.

According to TIF district rule 911, if a district plan approved by VEPC "included the utilization of income generated by infrastructure financed with district increment to ensure the viability of the district, that income must be utilized in accordance with the district authorization document issued by VEPC." The parking garage was financed with TIF district debt, and the City committed to using parking garage revenues to finance the TIF district in the plan approved by VEPC. As a result, the parking garage revenues should have been used for this purpose.

The City pointed out that they contributed more than the required share of municipal tax increment and this made up for the failure to use the parking garage revenue. According to TIF Rule 911, the City did not have the authority to exclude parking garage revenues.

AGO Guidance on Changes to TIF District Plan

SAO consulted with the AGO for guidance as to whether the differences between the TIF District Plan approved by VEPC and the City's implementation of its TIF district constituted a substantial change.

According to the AGO guidance, the lack of a statutory definition suggests that the phrase substantial change should be given its ordinary meaning – that is a change that is considerable, significant, or important. The AGO points out that

³⁷ Sum of \$15,156,482 of costs financed with TIF district debt through FY2017, Table 3, and the City's plan to use \$2.5 million of TIF district financing for Main and Congress.

the constant theme of the TIF statute and rules is that TIF District Plan must be approved by VEPC.

The AGO concluded that the changes are substantial by several measures including: spending on the ACE hardware project (which was not in the original plan), spending on approved projects significantly above costs estimated in the TIF District Plan, and the lack of progress on multiple planned projects. According to the AGO, these demonstrate a substantial change in the St. Albans TIF district that require a review by VEPC.

Reasons for Failure to Submit Substantial Change Review Request Prior to Audit

The City Manager indicated that the City views the Final Determination as an authorization, but not an obligation. Further, his perspective is that the Final Determination is the broad authorization of categories and the voter-approved projects are the specifics. Consistent with this perspective, the City's tracking tool is primarily focused on tracking costs according to what was described in municipal bond offering documents and disclosed to municipal voters in the ballots rather than what was approved by VEPC. A city official acknowledged that the City does not reconcile actual TIF expenditures for each project as included in the Final Determination. Expenses for each project are reconciled in accordance with the amounts approved by voters. Tracking costs by voter-approved projects and failing to reconcile to the VEPC-approved improvements may have impacted the City's ability to recognize the extent to which actual costs differed from the VEPC-approved amounts.

Another factor that may have inhibited VEPC's monitoring is incorrect data in the VEPC workbook used by the City to file annual required reports through FY2017. VEPC developed a standard workbook for municipalities with TIF districts to submit the annual report. Some data is pre-populated such as the estimated improvement costs approved by VEPC to be financed with TIF district debt for each municipality. For the City's workbook, VEPC staff input incorrect amounts for the estimated improvement costs, overstating the amount approved for financing by \$5,528,097. In addition, according to the total costs in the City's tracking tool, the City understated the amounts in the annual report workbooks it submitted to VEPC by approximately \$2 million through FY2017. City management indicated that they had not performed a reconciliation exercise to determine whether the amounts in the tracking tool and the amounts reported in the annual report were aligned. The inaccuracies in the improvement cost data may have hindered VEPC's ability to identify the extent of the changes to the City's TIF District Plan.

Per VEPC staff, the amounts for the improvement costs in the workbook for the City have been corrected. They also made changes to the standard workbook to better support VEPC's monitoring of TIF districts. These changes include the addition of a tab for VEPC's use that is intended to facilitate identification of changes to previously reported amounts. VEPC staff have also commenced monitoring visits to municipalities with TIF districts and the procedures performed include comparison of the information submitted in the annual report to municipal records.

Lastly, the TIF Rules define a substantial change as "an amendment that may result in a significant impact with respect to any of the criteria for approval" by VEPC. The rules provide guidance about some changes, such as the addition of a property to the TIF district, that require a substantial change request be submitted. However, there is no guidance about the types of changes to improvements that require a substantial change request. VEPC's 2012 substantial change policy provided examples such as eliminating or adding an infrastructure improvement or adding substantial cost. As the AGO noted, VEPC might add a few benchmarks to the TIF rules, such as percentages, dollar amounts, or events that would trigger the reporting requirement (e.g. substantial change request).

TIF District Debt Proceeds Used to Make Debt Payments

The City used \$192,639 and \$162,456 of TIF debt proceeds (the borrowed funds) to make debt service payments on TIF district debt in FY2016 and FY2017, respectively. According to the City's audited financial statements, from FY2013 to FY2017, the City used \$911,803 of TIF debt proceeds to make debt service (principal and interest) payments. Per the City Manager, an additional \$83,054 of debt proceeds was used to pay debt service in FY2018. Cumulatively, \$994,857 of the \$16,000,000 of TIF debt issued was used to pay debt service. The City plans to use an additional \$40,000 in FY2019.

This use of debt proceeds was not part of the TIF District Plan approved by VEPC in August 2012. However, a city consultant and the city manager informed attendees of public meetings held prior to a vote on TIF district debt in September 2013 that a "working capital fund" would be established with \$1,250,000 of the debt proceeds. The consultant explained that in the early stages of the TIF district the working capital fund would provide a cushion to pay debt service as the working capital fund covers shortfalls in tax increment. Through FY2017, tax increment was insufficient to make debt service payments. The total shortfall was approximately \$1,275,000.

During the audit, a city official indicated that the working capital reserve was used to pay debt service in order to alleviate pressure on the General Fund

(City's main operating fund). Based on the audited financial statements from FY2013 to FY2017, debt proceeds from TIF district debt issuances were recorded in the TIF Capital Projects Fund, not in the so-called "working capital fund" or a "working capital reserve." Debt proceeds were transferred from the TIF Capital Projects Fund to the TIF Debt Service Fund, which is used to account for debt service on voter approved TIF bonds.

In response to SAO's request for the City to substantiate that using TIF debt proceeds to pay debt service was an allowed use, the City obtained legal advice from the attorney the City uses in connection with debt financing. In a legal memo, the attorney cited the definition of improvements in 24 V.S.A., Chapter 53, Subchapter 5, which is limited to infrastructure, public facilities, land and other hard, tangible assets of the sort listed in 24 V.S.A. §1891(4).³⁸ He nevertheless argues that this definition is not controlling – that it should not be read in a vacuum - and that TIF bond proceeds may be used for all manner of soft costs, including the funding of reserves to pay debt service on the bonds.

In support of its argument for an expansive reading of improvements, the City's attorney cites a definition in 24 V.S.A., Chapter 53, Subchapter 1 and indicates it must be read with 24 V.S.A. §1891(4). Subchapter 1 deals with municipal debt generally and defines improvements more broadly than the tangible assets definition that applies to TIF district debt. For example, the Subchapter 1 list of improvements that may be financed using bond proceeds includes "the funding of reserves."

According to guidance from the AGO, TIF district bond proceeds may not be used to pay the debt service on those bonds. The AGO's view is:

"...[the] Legislature intended to treat TIF bonds as a special category of debt subject to special rules. This is evident from the text of the 'improvements' definition in Subchapter 5, which is quite specific and obviously narrower than the definition in Subchapter 1. If the Legislature intended to allow TIF bond proceeds to be used for a broad category of 'improvements,' including debt service, it could have used the broad language that it used in Subchapter 1. Or, it could have cross-referenced the Subchapter 1 definition of 'improvements' and made it applicable to TIF debt. The Legislature did neither. Rather, it enacted a different and narrow definition of improvements when it enacted Subchapter 5 (the TIF subchapter)." The AGO explains that the Legislature "took unusual care to establish a special rule of construction for Subchapter 5" and notes that "Subchapter 5 'is intended as an independent and comprehensive

³⁸ These include utilities, transportation, public facilities and amenities, land and property acquisition, and demolition, and site preparation.

conferral of powers to accomplish the purposes set forth herein.’ 24 V.S.A. §1898(a) The plain meaning of the TIF statutes should not be compromised based on definitions that appear in other subchapters in the debt statutes.”

In addition to violating statutory requirements for use of financing, the City’s diversion of approximately \$1 million of debt proceeds to repay TIF district debt could have a negative effect on the amount of tax increment that will be generated over the life of the TIF district. This is because these debt proceeds haven’t been used to fund improvements and it is improvements that are intended to incent the real property development that increases property values and generates tax increment.

VEPC Approved Substantial Change Request and Revised Financing Plan with Conditions

The Final Determination included a requirement for the City to file a revised financing plan by March 31, 2017 because of the nature of infrastructure cost estimating and the reliance on non-TIF revenue such as federal and state grants and parking garage revenues to maintain a positive revenue flow for the TIF district. The City did not submit a revised financing plan according to the March 31, 2017 timeline. The TIF Rules, effective May 6, 2015, also required those municipalities intending to extend the debt borrowing period from five to ten years to submit a revised financing plan using the substantial change process within six months of the effective date of the rules.

Communications with the then VEPC Executive Director in December 2017 about extending the borrowing period and adding another improvement project indicate that the Director and VEPC’s legal counsel determined that a summary update would suffice, and a substantial change wasn’t required.

The City then provided an update at VEPC’s February 2018 meeting.

Subsequently, at VEPC’s request, the City submitted a revised TIF financing plan on January 10, 2019.

The City insisted it had not made a substantial change to its TIF District Plan, but because of the audit’s findings, the City also submitted a substantial change request to VEPC in January 2019 and requested approval for the revised financing plan.³⁹

The City’s revised financing plan incorporated the City’s use of TIF district debt for ACE Hardware and the increased cost overall for core brownfield, reduced spending for improvements such as the Federal Street Multi-Modal

³⁹ The VEPC Executive Director and SAO inquired about aspects of the revised financing plan and on January 23, 2019, the City submitted a second version of the revised financing plan.

project, reduced the amount of borrowing, and excluded parking garage revenues. The City also presented a cash flow forecast for debt repayment that included using 100 percent of the municipal increment, rather than the 75 percent that was approved in 2012 in the original TIF District Plan. The City acknowledged the use of debt proceeds to pay for TIF district debt service. The revised financing plan did not address the City's use of TIF district debt for costs associated with the private hotel development.

On February 28, 2019, VEPC approved the City's substantial change request with the following conditions: (1) the total amount of debt the City could incur was reduced from \$23 million to \$21 million; (2) the City will repay the working capital reserve the amounts used to pay debt service and use those funds for future voter-approved TIF projects; and, (3) the municipal increment share retained is raised to 100 percent.

Although VEPC is requiring repayment of the so-called working capital reserve, the council did not address timing for repayment and did not specify the resources to be used to accomplish repayment. The City informed SAO that they believe the obligation does not arise until the end of the district. In the substantial change materials submitted to VEPC, the City indicated that they intend to use tax increment to repay the so-called working capital reserve.

We are concerned about the City's potential repayment timeline and whether its intent to use tax increment is allowed by statute. Accordingly, we requested guidance from the AGO about whether tax increment may be used to repay the so-called working capital reserve. As of the date of this report, this issue remains outstanding.

On April 18, 2019, the City submitted another substantial change request to VEPC seeking approval for a variety of items, including the use of tax increment to repay the so-called working capital reserve.

Objective 2: Insufficient Amount of Tax Increment Retained for TIF District and Education Increment Owed to Education Fund

The City calculated the FY2017 tax increment as \$1,038,800 and retained \$779,619 for payment of TIF district debt, but these amounts are understated. Consistent with guidance from its legal counsel, city officials treated the city-owned parking garage (constructed in the TIF district) as tax-exempt and excluded it from the calculation of tax increment. However, the

AGO advised SAO that the parking garage is taxable. Based on the value of the parking garage in the city-certified property valuation records required to be submitted annually to the Vermont Department of Taxes (VDT), SAO estimates additional education tax increment and municipal tax increment of \$148,061 and \$84,814 in FY2017. Cumulatively, from FY2016 to FY2018, SAO estimates the City understated tax increment by \$447,547 for the education tax increment and \$252,244 for the municipal tax increment because it excluded the parking garage. As a result, based on the value of the parking garage in the records submitted to VDT, SAO estimates the City owes the state Education Fund \$111,886 (25 percent of education tax increment) and the TIF district \$524,844 (75 percent of both education and municipal tax increment). City officials asserted that the value in the city's property records is not based on any formal methodology or is based on an inconsequential analysis. These officials also contend that the facility, which opened in October 2014, essentially has no value. However, the City Manager indicated they have contacted an appraiser from a list of certified appraisers maintained by the Property Valuation and Review (PVR) division of VDT and will obtain an independent appraisal and work with PVR to determine, what, if anything, should be paid.

City's Calculation of Tax Increment and Amount to Retain

As of June 30, 2017, the City's records showed that taxable property values in the TIF district had increased \$42,053,437. According to the City's FY2017 calculation, total education tax increment from this growth was \$661,347 and total municipal tax increment was \$377,453.

The City may retain up to 75 percent of the education tax increment through FY2033 and must retain no less than an equal percentage of the municipal tax increment. In FY2017, the City retained \$496,529 of the \$661,347 education property tax increment (75.1 percent) and recorded it as tax increment revenue in the TIF Debt Service Fund. The amount of education tax increment retained was about \$2,000 higher than the City's calculation showed it should have been. The remaining 24.9 percent was allocated to the State (on behalf of the Education Fund).

This small error occurred because the city finance staff did not aggregate the negative increment for homestead properties (a \$187,300 reduction in homestead values) shown in the TIF Proceeds report with the increment generated by non-residential properties which resulted in the error in the amount to be retained.⁴⁰ The City utilizes the New England Municipal Resource Center (NEMRC) accounting system which produces the TIF

⁴⁰ The education tax increment is comprised of two components – homestead and non-residential – as there are distinct property tax rates for each.

Proceeds report that shows the incremental municipal and education property value and the results of the calculation of incremental property tax revenue. The system calculates the 75 percent of education tax increment allowed to be retained and the 75 percent of municipal tax increment required to be allocated to the TIF district. According to the City's Director of Administration, an adjustment has been recorded in FY2018 to correct for the excess retained in FY2017. The City does not have a documented policy or procedure that addresses interpretation of the NEMRC report and compliance with the tax increment calculation requirements of TIF Rule 904.

As required by statute, \$283,090 of \$377,453 of municipal tax increment (75 percent) was allocated to and recorded as tax increment revenue in the TIF Debt Service Fund. According to the City, it has recorded 100 percent of the municipal tax increment in the TIF Debt Service Fund, not just the required 75 percent. In FY2017, the City recorded a transfer of \$144,363 from the General Fund to the TIF Debt Service Fund which exceeds the 25 percent municipal tax increment (\$94,363).

Tax Status of Parking Garage

The City characterized the parking garage constructed in the TIF district as tax-exempt and excluded it from the tax increment calculation. An opinion from the City's attorney, supporting the position that the garage is tax-exempt, states that the public use test⁴¹ is not relevant to determining the taxability of municipally-owned real estate, because "the General Assembly, by inference, has declared virtually all of such property to be exempt from taxation." The AGO disagrees, citing the Vermont Supreme Court's ruling in Stiles, 76 Vt. At 164, that "the ultimate test is not municipal ownership, but public use." The City's attorney looks to 32 V.S.A. §3659 and indicates that to subject municipally-owned property to taxation, an explicit mandate is required. The AGO notes that this provision "addresses the narrow issue of taxation of municipal land located in another municipality; it does not address or negate the public use requirement established in Stiles."

The City's attorney also cites 32 V.S.A. §5401(10)(F), which defines nonresidential property as excluding "[p]roperty owned by a municipality which is located within that municipality and which is used for municipal purposes." The AGO states that:

"from this language it is clear that mere ownership of property by a municipality does not imbue the property with a municipal purpose

⁴¹ The public use test, established by the Vermont Supreme Court, is based on three criteria: (1) the property must be dedicated unconditionally to public use; (2) the primary use must benefit an indefinite class of persons who are part of the public, and must also confer a benefit on society as a result of the benefit conferred on the persons directly served; and (3) the property must be owned and operated on a not-for-profit basis.

– otherwise the exclusion would have ended with the phrase ‘owned by a municipality’ and would not have needed the clause ‘used for municipal purposes.’”

The AGO advised that

“there is no indication and it is unlikely that the Legislature would have intended to overrule years of common law requiring a public use by simply adding a definition to an entirely separate section of the tax statutes,” and “the Legislature’s intent is also demonstrated by the unsuccessful attempts to amend Section 5401(10)(F) in 2015 and 2016 to explicitly exclude municipally-owned parking garages. If that is what the Legislature had intended, it would have enacted the proposed language.”

The AGO concludes that the St. Albans parking garage is taxable and is not unconditionally dedicated to a public use, but rather is primarily committed under two perpetual parking easements to the exclusion of the public.

Impact of Exclusion of Parking Garage

Because the City treated the parking garage as tax-exempt, it excluded the garage from the calculation of tax increment. To estimate the amount the tax increment was understated, SAO utilized the value of the parking garage included in the city-certified abstract of the grand list⁴² which is required to be submitted annually to the PVR division of VDT. Based on this calculation, SAO estimated the amount of tax increment that should have been allocated to the TIF district and the amount owed to the state Education Fund.

SAO estimates that the City’s FY2017 calculation of education tax increment and municipal tax increment was understated by \$148,061 and \$84,814, respectively. Cumulatively, from FY2016 to FY2018,⁴³ SAO estimates the City understated tax increment by \$447,547 for the education tax increment and \$252,244 for the municipal tax increment. As a result, SAO estimates the City owes the state Education Fund \$111,886 (25 percent of education tax increment) and the TIF district \$524,844 (75 percent of both education and municipal tax increment). See Appendix IV for the details of the calculation.

⁴² The grand list book is the basis for the collection of all property taxes in the State and must contain a listing for every real estate parcel, all taxable personal estate, and all exempt property. The exempt property must have a value and method of valuation, either insurance or assessment.

⁴³ The estimate starts with FY2016 because the assessed value for the parking garage was first included in the Grand List filed with the Vermont Department of Taxes for this period.

City officials asserted that the value in the city's property records is not based on any formal methodology or is based on an inconsequential analysis. These officials also contend that the facility, opened October 2014, essentially has no value because expenses have far exceeded revenues. The officials may be alluding to the income approach to valuation. The VDT Lister and Assessor Handbook advises that there are various approaches to property valuation, but indicates that for the income approach,⁴⁴ the income and expense figures should come from the market, not simply from the subject.

VDT maintains a list of certified professional appraisers for use by municipalities from which the City may select an appraiser to assist with valuation of the parking garage going forward. The City Manager indicated they have contacted an appraiser from PVR's list and will obtain an independent appraisal and work with the PVR division of VDT to determine what, if anything, should be paid. City officials recognize that values reported to PVR in previous grand lists may not be adjusted, but city officials hope there may be an opportunity to address inaccuracies such as may occur during a tax appeal or negotiated settlement process. According to PVR, any adjustment in the valuation of the parking garage would be part of the City's inventory on April 1, 2019 and take effect in grand list 2019.

Regardless of the value determined by the appraiser and whether adjustments to values in the grand list previously submitted to PVR are allowed, the City owes the state Education Fund 25 percent of the education tax increment and the TIF district 75 percent of the education and municipal tax increments for the periods that the value of the parking garage was omitted from the calculation.

Objective 3: FY2017 TIF District Debt Payments an Eligible Use of Tax Increment

In FY2017, incremental tax revenue of \$779,620 was used for payment of TIF district debt. This is an eligible use of tax increment per 24 V.S.A. §1894(1), 24 V.S.A. §1896(a), and TIF Rule 714 if the appropriate approvals for the debt are obtained and the debt is issued within the allowed period. The City obtained the requisite approvals, including municipal voter approval, disclosing most of the required information to voters prior to the public votes. The City issued its first general obligation (GO) bond in January 2014 within the allowed period (within five years of the establishment of the TIF district in 2012).

⁴⁴ Per the handbook, expenses are deducted from gross income and the resulting net operating income is capitalized to determine value.

As of FY2017, the City had issued \$16 million in GO bonds to finance TIF district projects.

VEPC Approval

The TIF district finance plan must be submitted and approved by VEPC before a municipality can seek a public vote to pledge the credit of the municipality (i.e., issue debt). VEPC approved the City's financing plan in August 2012, authorizing TIF district debt of \$33,682,896 (\$23,109,922 of debt principal and \$10,572,974 of interest).

City's Compliance with Public Notice Requirements Prior to Obtaining Voter Approval

Prior to April 1, 2013, statute required that legal voters of the municipality authorize a specified maximum dollar amount for all debt obligations to be financed with tax increment and authorize the legislative body (e.g., city council) to pledge the credit of the municipality for purposes of issuing bonds. Statute also required that a public meeting be held and that voters should be notified that if the tax increment is insufficient to pay the principal and interest on the debt, the municipality is liable for full payment of principal and interest for the term of the debt.

In November 2012, the City obtained approval from voters for a maximum debt ceiling of \$43 million to be financed with tax increment, but VEPC limited that the total amount the City may finance to the \$33,682,896 approved in the TIF district's financing plan and Final Determination issued in August 2012.

Subsequently, the City held a public hearing and vote in March 2013 for the issuance of \$3 million of general obligations. The City met disclosure requirements when the City's first debt of \$3 million in general obligation bonds was approved by voters in March 2013.

Effective April 1, 2013, the public notice requirements were expanded to include (1) the new amount of debt proposed, (2) total outstanding debt, (3) types of debt, (4) interest and fees, (5) term of debt, (6) improvements and related costs to be financed, and (7) expected development.⁴⁵ The statutory provisions do not address how the information is to be presented to voters.

The City complied with most disclosure requirements for a \$13 million bond vote held in September 2013. According to city officials, standard practice has been to have bond counsel draft the warning⁴⁶ for the bond vote. This

⁴⁵ 24 V.S.A. § 1894 (h-i)

⁴⁶ Warnings are notices informing voters of the town about an election or questions to be voted on.

document did not include all required information. The City's presentation materials for the public meetings included additional required information, except for interest and fees and term of the debt. Although the presentation did not include these specifics, the City presented a range of annual debt payments, which included interest.

According to guidance provided by the AGO, statutory notice in the context of public meetings is designed to ensure that the public receives sufficient – and sufficiently advance – information to be reasonably informed of a topic for public action. The City Manager believes that the term of the debt was disclosed during the public meetings, but the City's presentation materials and the minutes for the meetings do not reflect that the term was disclosed. As a result, it is not clear whether voters understood the full estimated cost of the bond.

This deficiency may have occurred because the statutory requirements for information to be provided prior to a public vote changed substantially effective April 1, 2013.

In May 2015 the TIF rules were issued, and Rule 1003.2.2 clarified that an informational notice must be provided to voters and detailed the information required to be included, such as interest, fees and terms of debt. The rules also stated that public information notices must be provided to VEPC in advance of the public vote. In addition, VEPC staff use a checklist to review the disclosures made in advance of public votes, and VEPC provided it to municipalities with TIF districts in November 2018. The improved guidance in the TIF Rules, the requirement to provide the public information notice to VEPC, and the checklist provided to the municipalities may result in improved future disclosures to the voters.

Other Matters

The following matters came to our attention as we reviewed costs financed with TIF district debt. Our review focused on the eligibility of costs under the TIF district statute and TIF Rules and we did not review St. Albans' processes and procedures for contracting in general. As a result, we are not making any recommendations, but we believe these matters warrant the attention of city government.

Bid process

SAO noted that some City projects followed a competitive bid process, such as the streetscape construction projects in FY2016 and FY2017, but we found that some professional services were not competitively bid. According to the

City Manager, real estate investment advisory services and legal services have never been put out to bid and one of these advisors was paid more than \$400,000 between FY2012 and FY2017, according to city records. The City's Financial Policy Handbook, approved by City Council, requires that all purchases of \$50,000 or more, including professional services, shall be subject to a bid process. The purchasing policy cites many purposes such as obtaining the highest quality goods and services at the lowest possible prices and allowing fair and equal opportunity among qualified suppliers. The bid process is a component of the policy intended to achieve these aims. Lacking competitive bids for some of its professional services, the City may not meet the objectives of the purchasing policy.

Contracting form

The City did not have contracts with some of its professional advisors and paid a vendor for services performed before a contract was executed and in excess of contractually agreed amounts.

- **Lack of contracts:** The City does not have a current documented agreement for all services provided by a real estate investment advisor who was paid more than \$400,000 between FY2012 and FY2017.⁴⁷ The most recent documented arrangement⁴⁸ was from 2011 for services described as 'City of St Albans Tax Increment Finance District Application Management Services'. The letter provided an estimated timeline for services of less than one year and included an estimated good faith fee of \$25,000 based on staff hours. The letter also provided that the adviser may change their fee schedule, but not more than once in a calendar year. The City also advised SAO that they did not have a contract or engagement letter in place for a City legal advisor. The City said that if they are unsatisfied with their professional advisers' performance or price, they address it in the context of on-going services. The City maintains some contracts with their primary professional engineer who manages construction progress on projects, including some TIF district projects, and reviews and approves the content and charges in construction invoices. However, in an email to the City, the engineer confirmed that he had not entered contracts with the City for all the specific projects that he had issued invoices to the City for services rendered. The City cited their understanding of the engineer's rates and their long-standing relationship with the engineer as a reason for not having a signed contract in place.

⁴⁷ This advisor did have an exclusive right to market agreement with the City and was paid \$100,000 in FY2016 in connection with the agreement. This amount is in addition to the payments that were greater than \$400,000.

⁴⁸ The arrangement was documented in a proposal letter from the advisor which was signed by the City Manager.

- **Lack of contract for some payments and payment in excess of contract maximum for vendor:** The City paid a trucking vendor \$80,478 for services where no governing contract was in place. The City then entered two contracts with that same vendor. The first contract was for \$20,750 but the amount paid by the City was \$28,373. The second contract included payment calculated on a rate per ton. There was no maximum payment value or estimated tonnage established in the terms.

The City has a documented purchase authorization process, including a requirement for review and approval by two City Council members. SAO noted that two city council members approved invoices prior to payment in accordance with this policy. However, the City's Financial Policy Handbook and Finance & Administration Accounting Procedures Manual do not address contracting practices such as when a contract is required and whether standard terms and conditions should be included. The City's lack of a documented contract process and clear contractual terms to govern relationships with its professional advisors and vendors may increase risks to the City in the event of disagreements.

Contracting authority

SAO observed that some contracts for the City were signed only by the City Manager, including high value contracts. For example, one contact for a streetscape project with a contracted value of \$2,234,700 was signed solely by the City Manager.

The city charter states that the City Manager shall act as a purchasing agent for all City departments, except schools.⁴⁹ However, Chapter 9 section 241 of the City's Revised Ordinances sets out that no contract shall be made to bind the City for the payment of any sum of money unless the same has been previously authorized by the City Council. In addition, Chapter 9 section 242 states the following, "No city office shall have any authority or power to bind the city for the payment of any sum of money for any purpose, or to make any contract whereby the city may become bound for the payment of any sum of money, unless such office shall have been previously authorized to such action by city council."

City management advised SAO that the council does not approve professional services agreements, but it does approve large agreements, such as: the investment agreement for the hotel or development agreements such as the state office building. City management indicated that the council's form of approval often varies, ranging from tacit acknowledgement and assent to formal action. City management also advised that the language in the

⁴⁹ 24A V.S.A. § 11-11(d)(6)

Ordinance - “unless the same shall have been previously authorized by the City Council” - is interpreted to mean that the adoption of the city manager form of government and subsequent hiring of the manager is the ‘previous authorization.’ Further, management explained that the City Manager is the general manager of the City and this derives from the charter, state law, and the culture of the City of St Albans.

The authority of the ‘purchasing agent’ is not addressed in the city charter and the city ordinances require city council to authorize contracts. Further, the City’s Finance Policy Handbook does not address contracts or authorization levels for contracting. As a result, it is not clear what level of authority the City Manager has for contractually obligating the City.

Conclusions

SAO reviewed most of the \$752,872 and \$756,410 of costs financed with TIF district debt in FY2016 and FY2017, respectively, and concluded that \$631,405 in FY2016 and \$315,871 in FY2017 was used for eligible infrastructure improvements and related costs. However, the City also used \$119,331 in FY2016 and \$434,361 in FY2017 primarily for costs associated with the development of a privately-owned hotel, and SAO questioned whether the costs were eligible to be financed with TIF district debt. SAO also noted many changes to the TIF district plan approved by VEPC in 2012, and the AGO determined that the City should have submitted a substantial change request to VEPC. Lastly, SAO identified use of almost \$1,000,000 of TIF district debt to pay for TIF district debt service (principal and interest), which the AGO concluded is not allowed under the TIF statutes. The City addressed departures from the 2012 VEPC-approved TIF District Plan noted in the audit by submitting a revised financing plan and request for substantial change to VEPC in January 2019. VEPC approved the City’s substantial change request in February 2019 with conditions, including that the City repay the working capital reserve the amounts used to pay debt service and use those funds for future voter approved TIF projects.

The City’s calculation of the FY2017 tax increment was understated because the City treated a city-owned parking garage (opened October 2014 in the TIF district) as tax-exempt, excluding it from the calculation. The City’s legal counsel supported the City’s treatment of the garage as tax-exempt, but the AGO advised SAO that the parking garage is taxable. Using the value of the parking garage in the grand list submitted by the City to PVR, SAO estimates the City understated the education tax increment (FY2016 to FY2018) and owes the state Education Fund \$111,886 and the TIF district \$524,844. The City asserts that the value in the city’s property records is not based on any formal methodology and has contacted an appraiser to obtain an

independent appraisal. The City plans to work with PVR to determine what, if anything, should be paid because the City believes there may be an opportunity to address inaccuracies. According to PVR, any adjustment in the valuation of the parking garage would be part of the City's inventory on April 1, 2019 and take effect in grand list 2019. Regardless of the value determined by the appraiser and whether adjustments to values in the property records previously submitted to PVR are allowed, the City owes the state Education Fund 25 percent of the education tax increment and the TIF district 75 percent of the education and municipal tax increments for the periods that the value of the parking garage was omitted from the calculation.

In FY2017, incremental tax revenue of \$779,620 was used for payment of TIF district debt which SAO concluded was an eligible use because appropriate approvals for the debt were obtained, and the debt was issued within the allowed borrowing period. The City disclosed all the required information prior to a public vote to approve \$3 million of bonds in March 2013. It also disclosed the required information, except for the term of the bonds, prior to the public vote in September 2013 to approve \$13 million of bonds. The City Manager believes the term of the debt was disclosed in public meetings held prior to the vote, but the City's presentation materials and the minutes for the meetings do not reflect that the term was disclosed. As a result, it is not clear if voters understood the full estimated cost of the bond. This deficiency may have occurred because the statutory requirements for information to be provided prior to a public vote changed substantially effective April 1, 2013. In May 2015, the TIF rules were issued and detailed the information required to be included in an informational notice to be provided to voters. This additional guidance and a checklist that VEPC provided to municipalities with TIF districts to review the disclosures made in advance of public votes may result in improved future disclosures to the voters.

Matters for Legislative Consideration

We recommend that the Legislature amend 24 V.S.A §1891(7) to clarify whether related costs may be financed with TIF district debt.

Recommendations to Management

SAO makes recommendations in Table 4 to the City Manager of the City of St. Albans.

Table 4: Recommendations and Related Issues

Recommendation	Report Pages	Issue
1. Seek VEPC guidance about whether the costs associated with the private hotel development are eligible improvement costs or related costs that may be financed with TIF district debt.	20-24	Vermont Statutes and the TIF Rules are silent about whether costs such as a brokerage fee associated with a private development project are considered related costs. Neither the statutes nor the TIF rules address whether paying for costs on behalf of a private development project are improvements eligible to be financed with TIF district debt. A July 2017 VEPC Frequently Asked Questions (FAQ) document states that the cost of the direct infrastructure a developer needs to complete their project must be borne by the developer. However, the FAQ does not define “direct infrastructure,” so it is not entirely clear if the costs paid by the City are considered direct infrastructure.
2. If VEPC determines that the types of costs that the City paid on behalf of the private hotel development are eligible improvement costs or related costs, the City should consult with VEPC and city legal counsel to determine, what, if any, remedial action is required to address that TIF district debt was used for costs that were not part of an infrastructure improvement approved by VEPC and were not adequately disclosed to city voters.	20-24	See issue described under recommendation #1. The core brownfield improvement, as approved by VEPC, was limited to mitigation of brownfield conditions and most of the costs associated with the private hotel development were not brownfield remediation activities. Municipal voters approved the use of TIF district debt for brownfield clean-up at the hotel development site on Lake Street, but none of the evidence provided by the City or available on the City’s website indicates that voters were informed that the brownfield clean-up at the hotel would include a brokerage fee and site improvements for the benefit of the hotel.
3. If VEPC determines that the types of costs associated with the private hotel development are not eligible improvement costs or related costs, the City should repay the TIF Capital Projects Fund to remedy the ineligible use of TIF district debt proceeds.	20-24	See issue described under recommendation #1.
4. Monitor actual costs according to the improvements and related costs approved by VEPC and compare actual costs to the amounts approved by VEPC.	28	The City’s tracking tool is primarily focused on tracking costs according to what was described in the municipal bond offering documents and disclosed to municipal voters in the ballots rather than what was approved by VEPC. This may have impacted the City’s ability to recognize the extent to which actual spending differed from VEPC-approved amounts.

Recommendation	Report Pages	Issue
5. Implement a process to reconcile the TIF improvement costs and related costs per the City's records to the costs reported in the Annual Report to VEPC.	28	The annual reports filed by the City with VEPC through FY2017 understated by approximately \$2 million the costs funded with TIF district debt. City management does not perform a reconciliation exercise to determine whether the amounts in the tracking tool and the amounts reported in the annual report are aligned.
6. Repay the TIF Capital Projects Fund approximately \$1 million for the debt proceeds used for TIF district debt service.	29-31	The City used approximately \$1 million of TIF district debt proceeds to pay for TIF district debt service. The AGO advised that this use of debt proceeds is not allowed by the TIF statutes. As a condition of approving the revised financing plan submitted in January 2019, VEPC required repayment of the so-called working capital reserve. The City informed SAO that they believe the obligation to repay the so-called working capital reserve does not arise until the end of the district. In the substantial change materials submitted to VEPC, the City indicated that they intend to use tax increment to repay the so-called working capital reserve. Because VEPC did not indicate a timeline for repayment or whether tax increment could be used, SAO consulted with the AGO. This issue is open as of the date of the report.
7. Establish a documented procedure that addresses accurate interpretation of the NEMRC TIF Proceeds report and compliance with the tax increment calculation requirements of TIF Rule 904.	33-34	The City may retain up to 75 percent of the education tax increment through fiscal year 2033. In FY2017, the City retained \$496,529 of the \$661,347 education property tax increment (75.1 percent) and recorded it as tax increment revenue in the TIF Debt Service Fund. The amount of education tax increment retained was about \$2,000 higher than the City's calculation showed it should have been. The City does not have a documented policy or procedure that addresses interpretation of the NEMRC report and compliance with the tax increment calculation requirements of TIF Rule 904.
8. Conduct an appraisal of the City-owned parking garage using one of the methodologies described in VDT's Lister and Assessor Handbook and treat the property as taxable.	34-36	The City has treated the city-owned parking garage as tax exempt, but the AGO advised that the parking garage was taxable. Although the City property records included a value for the parking garage for FY2016-FY2018, the City indicated that there was no formal methodology underlying the valuation.

Recommendation	Report Pages	Issue
9. Consult with VDT's PVR division to determine the impact of excluding the parking garage from the calculation of tax increment from FY2016 to FY2018; pay 25 percent of the education tax increment generated by the garage to the state Education Fund and 75 percent of the education and municipal tax increment to the City's TIF Debt Service Fund.	34-36	SAO used the assessed value of the parking garage included in the city-certified property valuation records submitted to the VDT to estimate the amount owed to the state Education Fund and the amount owed to the City's TIF Debt Service Fund. The City asserts that there was no formal methodology used to determine the valuation reported to PVR in the grand list book but intends to utilize an appraiser from PVR's list of certified appraisers and to work with PVR on determining the amount owed.

Management's Comments

On May 7, 2019, we received comments from the City Manager of the City of St. Albans. These comments are reprinted in Appendix VI and our evaluation is in Appendix VII.

Recommendations to VEPC

SAO makes the recommendations in Table 5 to the Executive Director of the Vermont Economic Progress Council.

Table 5: Recommendations and Related Issues

Recommendation	Report Pages	Issue
1. Amend the TIF Rules to address whether costs, such as brokerage or other professional service fees, incurred by municipalities in connection with private development projects are related costs eligible to be financed with TIF district debt.	20-21	Statute and the TIF Rules are silent about whether costs such as a brokerage fee and other professional service fees associated with a private development project are considered related costs. TIF Rule 705 provides some examples of related costs but does not provide an example of costs paid by municipalities for private development projects that qualify as a related cost. The rule does specify that related costs do not include any cost incurred by private entities undertaking development or redevelopment within a district.

Recommendation	Report Pages	Issue
2. Amend the TIF Rules to address whether site preparation or other costs paid by municipalities on behalf of a private development project are improvements eligible to be financed with TIF district debt.	20-21	Neither statutes nor the TIF rules address whether paying for site preparation and other costs on behalf of a private development project are improvement costs eligible to be financed with TIF district debt. A July 2017 VEPC Frequently Asked Questions (FAQ) document states that the cost of the direct infrastructure a developer needs to complete their project must be borne by the developer, so the costs paid by the City in connection with the hotel may not be eligible improvements. However, the FAQ does not define "direct infrastructure" so it is not clear if the costs paid by the City are considered direct infrastructure.
3. Define direct infrastructure in the VEPC FAQ document.	20-21	The City paid for costs on behalf of the private hotel development project. VEPC's FAQ document states that the cost of the direct infrastructure a developer needs to complete their project must be borne by the developer and that the cost of utility hookups is not an eligible improvement cost. However, the FAQ does not define "direct infrastructure" so it is not entirely clear if the costs paid for by the City are considered direct infrastructure.
4. Amend the TIF Rules to include examples of changes to improvements or indicators, such as percent of excess spending above the estimated cost for an approved improvement, that require submission of a request for substantial change.	26-27	In 2012, VEPC had a substantial change policy that provided examples of substantial change such as eliminating or adding an infrastructure improvement project and adding substantial cost to an infrastructure project. However, the TIF rules do not include guidance about the types of changes to improvement projects that require a substantial change request be submitted.

VEPC's Comments

On May 13, 2019, we received comments from the Executive Director and the Chair of VEPC. These comments are reprinted in Appendix VIII and our evaluation is in Appendix IX.

Appendix I

Scope and Methodology

To gain an understanding of the City of St. Albans TIF district, we reviewed the City's TIF application materials, VEPC's Final Determination, VEPC's Annual Reports for 2016 and 2017, and the City's audited financial statements from FY2013 to FY2017.

For our first objective, we identified the statutory provisions and TIF Rules that address infrastructure improvements and related costs eligible for TIF financing. We obtained guidance from the AGO addressing whether related costs may be financed with TIF district debt. We reviewed the City's finance and administrative accounting procedures and financial policy handbook for information pertinent to authorization and/or eligibility of infrastructure improvements and related costs. We interviewed the director of administration to determine whether a system of policies, procedures and controls was in place to ensure costs financed with TIF district debt are for TIF infrastructure improvements approved by VEPC and are for improvements or related costs as defined in statute and the TIF Rules.

We verified that the total costs for FY2016 and FY2017 per the City's TIF Summary of Expenses agreed to the amount of costs recorded as expenditures in the TIF Capital Projects Fund and any transfers from this fund to other city funds per the audited financial statements. We judgmentally selected a sample of infrastructure improvement costs and related costs from the TIF Summary of Expenses. We reviewed documentary evidence - such as: invoices, contracts, and request for proposal documents provided by the City - to assess whether the costs were for an improvement or related costs in the 2012 TIF District Plan approved by VEPC or through a substantial change request. We also assessed whether the costs met the definition of improvements and related costs in statute and the TIF Rules. We also compared the amount of costs per the TIF Summary of Expenses for FY2013 to FY2017 to the City's annual reports submitted to VEPC for these fiscal years.

To assess whether the City was required to submit a substantial change request to VEPC for changes from the 2012 VEPC-approved TIF District Plan, we reviewed the City's TIF Summary of Expenses for previous fiscal years and noted whether there were costs for improvements not included in the Final Determination and whether there were limited costs or no costs for improvements approved by VEPC in the Final Determination. Using the City's records, we compared actual costs of improvements and related costs to the estimated costs for improvements and related costs approved by VEPC. At our request, the AGO provided guidance about whether departures from the VEPC-approved TIF District Plan constituted a substantial change that would require review by VEPC.

Appendix I

Scope and Methodology

We utilized the audited financial statements to identify TIF debt proceeds transferred from the TIF Capital Projects Fund to the TIF Debt Service Fund in FY2016 and FY2017, and cumulatively since FY2013, to determine the amount of TIF debt proceeds used for TIF district debt service. We requested that the City consult with an attorney about which provisions of Title 24 Chapter 53, subchapter 5 allows the City to use TIF district debt proceeds to pay debt service. The City provided a legal opinion. We obtained guidance from the AGO.

For our second objective, we identified the statutory provisions and TIF Rules relevant to the calculation and retention of tax increment. We reviewed the method used by VEPC and PVR to certify the OTV of the district. We evaluated the certification of the OTV by VEPC and PVR by comparing the property list the district submitted with the application, including amendments to the certified OTV. Using TIF district maps, we identified the location of parcels added during certification. We calculated the effect of using the OTV (at the time the TIF district was created) to determine the tax increment for FY2017 instead of using the OTV certified by VEPC and PVR in February 2017. Using the date of the first debt, we calculated and documented the beginning and end of the tax increment retention period.

We validated the education tax rates to the published rates available on the Vermont Department of Taxes website and the municipal tax rates to published rates in the City's annual report. We obtained the NEMRC TIF Proceeds Report and TIF Parcel Value Reports and used this information, along with the education and municipal tax rates, to recalculate the education and municipal tax increment. We verified that the percent of education increment retained by the City was no greater than 75 percent, and the municipal increment was no less than an equal percentage. We traced and agreed the recalculated amounts to the City's general ledger and audited financial statements.

We requested the City provide its rationale for treating the municipal parking garage as tax-exempt and reviewed the information provided by the City's attorney. We also obtained a Vermont Department of Taxes document that addressed the tax status of parking garages. Based on the City's documented rationale and information provided by PVR, we consulted with the AGO regarding the tax status of the municipal TIF district parking garages. Using the value of the parking garage in the City's grand list, we calculated an estimate of the amount due to the state Education Fund and St. Albans TIF Debt Service Fund due to the impact of excluding the parking garage from the tax increment calculation.

Appendix I

Scope and Methodology

For objective three, we identified the statutory provisions and TIF Rules relevant to the types of allowed debt and the authorization and issuance of debt.

We validated that the first debt occurred within the first five years following creation of the district and determined the period during which St. Albans may borrow to pay for TIF improvement.

We verified that tax increment was used for debt payments in FY2017 by reviewing the City's audited financial statements. To assess whether the debt is eligible to be paid with tax increment, SAO verified that debt was approved by VEPC and town voters. We also corroborated the debt payment amounts in the audited financial statements with the bond amortization schedules and to the general ledger accounts.

We obtained copies of loan agreements, accompanying schedules, a copy of the actual bond and registration, the tax certificate, legal opinion, and the city council resolution of intent for all debt instruments on which payments were made in FY2017. We documented the amount of debt outstanding for each bond as of FY2017 and the total amount of principal and interest payments in FY2017. Furthermore, we created a debt history for the debts outstanding in FY2017 by reviewing the audited financial statements, annual reports to VEPC, and city council meeting minutes.

To determine whether the TIF district debt outstanding in FY2017 was approved by VEPC, we reviewed the 2012 TIF District Plan approved by VEPC to confirm that the amount of debt did not exceed the total authorized by VEPC.

To determine whether a debt ceiling and each bond were approved by municipal voters, we obtained ballots, public notices, and city council meeting minutes for the debt instruments on which payment was made in FY2017. We compared the disclosures in the ballots, public notices, and meeting minutes to the statutory criteria in effect when public approval was sought for each debt.

We performed our audit between May 2018 and February 2018, which included visits to the city offices in St. Albans City, Vermont. We conducted this performance audit in accordance with generally accepted government auditing standards, which require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II Abbreviations

AGO	Attorney General's Office
City	City of St. Albans
FAQ	Frequently Asked Questions
FY	Fiscal Year
GO	General Obligation
NEMRC	New England Municipal Resource Center
OTV	Original Taxable Value
PVR	Property Valuation and Review
SAO	State Auditor's Office
TIF	Tax Increment Financing
VDT	Vermont Department of Taxes
VEPC	Vermont Economic Progress Council

Appendix III

Improvements Approved by VEPC in August 2012

Table 6 contains the infrastructure improvements, related costs, and estimated TIF financed costs approved by VEPC in August 2012.

Table 6: Estimated Costs for VEPC-Approved Improvement Projects, Related Costs and Financing to be funded from TIF debt

Project name	Category	Estimated TIF Financed Costs
Taylor Park Master Plan	Park improvements	\$769,250
Structured Parking Garage	Structured parking	\$8,767,000
Federal St Multi-Modal Connector	Roadway improvements	\$6,512,389
Streetscape 2 & 3	Streetscapes	\$5,261,255
Stormwater Treatment	Stormwater	\$1,150,000
Core Brownfield clean-up	Brownfields	\$56,546
Fonda Brownfield clean-up	Brownfields	\$592,982
Subtotal - infrastructure improvements		\$23,109,922
Related costs		\$35,000
Total improvements and related costs		\$23,144,922

The following descriptions are a summary of the infrastructure improvements as described in the Final Determination approved by VEPC.

Taylor Park Master Plan Implementation

The master plan is to maximize the park's utilization by adding more public amenities (like event spaces and restrooms) and to update the aging infrastructure, such as sidewalks and utilities.

Structured Parking Garage

A 400-space parking garage located within the core of the major downtown block with a low visual impact and ideal accessibility.

Federal St. Multi-Modal Connector

The Federal Street Multi-Model Connector corridor spans from Lower Newton Road along Federal Street, Catherine/Market Street, Allen Street, and Lemnah Drive, connecting to the I-89 Access Road via a new road extension (north to south). The primary need for the connector project has to do with poor traffic management within the corridor and traffic impacts on Main Street downtown. This project is envisioned to include operational

Appendix III

Improvements Approved by VEPC in August 2012

improvements at intersections, access management and parking improvements, traffic and way finding signs, continuous sidewalks and improved pedestrian crossings throughout, on-street bike lanes, appropriate street lighting for each roadway segment, street trees where appropriate, bridge replacement at Stevens Brook, roadway pavement rehabilitation/reconstruction, drainage improvements, and municipal utility updates.

Streetscape - Phase 2 (Side Streets and down Lake St) & Phase 3 (Gateways, Way finding)

The project has phases, the first of which will be completed along Main Street. The next phases of streetscape improvements will create “complete streets” connections to the Federal Street Multi-Modal Connector project via the crossing streets of Stebbins, Kingman, Center, Hoyt and Hudson. The next phases will also extend down Lake Street past the boundary of the proposed TIF district. Finally, improvements will be made farther out along northern and southern Main Street to implement multi-modal connections and way finding. The projects will include reconstructed sidewalks with new materials, new pedestrian lighting with historic fixtures, realigned and rebuilt pedestrian crosswalks with new “bump-outs” where possible, re-paved streets with new striping for automobiles and bicycles, and improvements to intersection designs.

Storm Water Treatment Project

Storm water from the City’s core area between Federal and Main Street drains into the sewer system. The City needs to build a storm water treatment area to the north (outside the TIF District) for separated storm run-off.

Core Brownfield Clean-up

An environmental site investigation report identified the presence of polycyclic aromatic hydrocarbons and heavy metals in the soil and two potential Underground Storage Tanks (USTs) that are environmentally hazardous in the core of the main downtown block that is currently a surface parking lot (to be redeveloped into the parking garage described above). Prior to constructing anything - either the parking garage or the developable properties nearby - these brownfield conditions must be mitigated.

Fonda Brownfield Clean-up

Formerly a manufacturing plant, there are many environmental complications - primarily the presence of contaminants in the soil and groundwater that could be a risk to human health. In 2011 a brownfield remediation project costing \$900,000 (mostly federal funds) was completed to demolish the contaminated buildings and cover contaminated areas of the remaining concrete slab. The next phase in clean-up will be to develop and implement a corrective action plan to remove any remaining contaminants in the slab and soil on the site.

Appendix IV

Estimate of Tax Increment and Amount Owed

Table 7 shows SAO's calculation of estimated (1) additional tax increment, (2) amount owed to the state Education Fund, and (3) amount owed to TIF district. The value for the parking garage is from the city-certified property valuation records submitted to the VDT.

Table 7: Parking Garage Estimated Tax Increment, Amount Due the State Education Fund and TIF District

Description	FY2016	FY2017	FY2018	TOTAL
Value estimate	\$9,446,900	\$9,446,900	\$9,356,300	N/A
1% value estimate	94,469	94,469	93,563	N/A
Estimate - Education and Municipal Tax Increment				
Non-residential education tax rate	\$1.5697	\$1.5673	\$1.616	N/A
Municipal tax rate	\$0.8563	\$0.8978	\$0.9249	N/A
Education tax increment	\$148,288	\$148,061	\$151,198	\$447,547
Municipal tax increment	\$80,894	\$84,814	\$86,536	\$252,244
<i>Subtotal tax increment</i>	<i>\$229,182</i>	<i>\$232,875</i>	<i>\$237,734</i>	<i>\$699,791</i>
Estimate - Amount Owed to State Education Fund				
25% of education tax increment	\$37,072	\$37,015	\$37,799	\$111,886
Estimate - Amount Owed to TIF District				
75% of education tax increment	\$111,216	\$111,046	\$113,398	\$335,660
75% of municipal tax increment	\$60,670	\$63,611	\$64,902	\$189,183
<i>Subtotal</i>	<i>\$171,886</i>	<i>\$174,657</i>	<i>\$178,301</i>	<i>\$524,844</i>

Appendix V AGO memos

During the audit, SAO consulted with the AGO on various topics. The memos from the AGO providing guidance to the SAO on these topics are included below.

MEMORANDUM OFFICE OF THE ATTORNEY GENERAL

TO: Tanya Morehouse, Chief Auditor
FROM: Bill Griffin, Chief Assistant Attorney General
RE: Tax Increment Finance Districts – financing “related costs”
DATE: August 9, 2018

This is to follow up on our conversation about the Tax Increment Financing (“TIF”) statutes and the statutory restrictions on funds borrowed pursuant to those statutes. Your questions are:

1. Whether TIF debt may be used to finance “related costs” as well as “improvements”; and
2. Whether the statutes could benefit from some clarification.

In reverse order, my view is that the statutes are less than clear but may be read to allow TIF debt to be used to finance related costs.

There are at least two categories of tax increment financing. Title 24, chapter 53, subchapter 5 authorizes *statewide* tax increment financing. Title 24, chapter 53, subchapter 6 authorizes *municipal* tax increment financing. Both subchapters authorize public financing to build infrastructure for economic development.

The *municipal* TIF statutes are clear. They provide that a municipality “may create a municipal tax increment financing district, and may incur debt to provided funding for improvements and related costs for the district.” 24 V.S.A. § 1904(a). They define “improvements” as “infrastructure” including “utilities, transportation, public facilities, etc.” 24 V.S.A. § 1903(2). They define “related costs” as expenses “directly related to the creation and implementation” of a municipal TIF district. 24 V.S.A. § 1903(6).

The *statewide* TIF statutes are not so clear. They provide that a municipality “may create ... a special district to be known as a tax increment financing [TIF] district.” 24 V.S.A. § 1892(a). They provide that a municipality “may incur indebtedness against revenues of the tax increment financing district” 24 V.S.A. § 1894(a)(1). They define “improvements” and “related costs” using language similar to the language that defines these terms for municipal TIFs. See 24 V.S.A. § 1891(4) and (6). However, the statewide TIF statutes do not expressly provide that TIF debt may be used to provide funding for improvements and related costs – or not.

The definition of financing in the statewide TIF statutes suggests that TIF debt should be used to finance improvements only, and should not be used to finance related costs. See 24 V.S.A.

Appendix V AGO memos

§ 1891(7) (“Financing means debt ... used by a municipality to pay for *improvements* in a tax increment financing district ...”) (emphasis added). The counterpoint is that TIF financing plans are subject to approval by the Vermont Economic Progress Council (VEPC), *see* 24 V.S.A. § 1894(d), and the statute that governs the VEPC approval process contemplates “financing of the *improvements and related costs.*” 32 V.S.A. § 5404a(f) (emphasis added).

Also, the TIF Rules adopted by the VEPC assume that TIF debt may be used to pay related costs. For example, Rule 705 provides that:

When the municipality seeks voter approval for District financing and a portion of the proceeds will be used to reimburse the municipality for related costs previously advance or for projected related costs, the notice to voters required by statute must include the amount of the related costs and types to be reimbursed ...

Tax Increment Finance Districts Adopted Rule, Rule#15-P04, Rule 705.

Therefore, although the statutes are ambiguous, my opinion is that the statewide TIF statutes – like the municipal TIF statutes – should be read to mean that TIF debt may be used to pay “related costs” as defined by 24 V.S.A. § 1891(6). If your office plans to suggest legislative changes, you may want to suggest a change that would address this issue.

Hope this helps.

Page 2 of 2

Appendix V AGO memos

MEMORANDUM OFFICE OF ATTORNEY GENERAL

To: Tanya Morehouse, Chief Auditor
W/G
From: William Griffin, Chief Assistant Attorney General
Suzanne Monte, Assistant Attorney General
Re: St. Albans Parking Garage Located in TIF District
Date: November 27, 2018

This is in reply to your request for advice on the application of certain statutes and the rule affecting Tax Increment Financing Districts ("TIF districts"). More specifically, you have asked for an opinion with regard to the taxability of the parking garage constructed by the City of St. Albans (the "City") in its TIF district. It is our opinion, consistent with the opinion we provided to you regarding the Winooski parking garage, that the St. Albans parking garage is taxable.

As we discussed in our June 4, 2012 memo to you regarding the Winooski parking garage, municipal ownership alone does not make property exempt. Exemption of municipal property extends only to property devoted to a public use. *Stiles v. Village of Newport*, 76 Vt. 154 (1904) (branch of water system built by municipality outside of its corporate limits and devoted to needs of another village and which can never be made available for its own municipal service is not property devoted to a public use, and is not exempt from taxation). In the case of Winooski, the parking garage was primarily committed under four long term leases leaving only 5 percent of the spaces available to the public. As such, we concluded that the parking garage was not devoted to a public use and was taxable.

We have reviewed the following perpetual parking easements between the City of St. Albans and two private entities for the use of parking spaces in the St. Albans parking garage: (1) Parking Management Agreement between the City of St. Albans and 27 Federal Street, LLC (developer for New State Office Building), dated December 26, 2013, and (2) Parking Management Agreement between the City of St. Albans and PeakCM Lake Street Hotel, LLP (developer for Hotel Building), dated November 30, 2015. Together, these two perpetual parking easements restrict the use of a total of 275 out of 365 spaces in the parking garage.

We have also reviewed a memo from St. Albans' attorney, dated July 23, 2018, regarding parking garage taxation ("City's Memo"). The City's Memo notes the

Page 1 of 5

Appendix V AGO memos

test established by the Vermont Supreme Court for determining whether a property qualifies for exemption as a “public, pious or charitable use” pursuant to 32 V.S.A. § 3802(4), known as the *Fly Fishing* test:

- (1) the property must be dedicated unconditionally to public use;
- (2) the primary use must directly benefit an indefinite class of persons who are part of the public, and must also confer a benefit on society as a result of the benefit conferred on the persons directly served; and
- (3) the property must be owned and operated on a not-for-profit basis.

American Museum of Fly Fishing, Inc. v. Town of Manchester, 151 Vt. 103, 110, 557 A.2d 900, 904 (1989).

The City’s Memo concludes, however, that the public use test isn’t relevant to determining the taxability of the St. Albans parking garage. We disagree. As noted above, the Vermont Supreme Court has ruled that “the ultimate test is not municipal ownership, but public use.” *Stiles*, 76 Vt. at 164.

In support of its argument, the City’s Memo looks to 32 V.S.A. § 3659. However, Section 3659 addresses the narrow issue of taxation of municipal land located in another municipality; it does not address or negate the public use requirement established in *Stiles*. Even the case cited by the City’s Memo, *City of Montpelier v. Town of Berlin*, 143 Vt. 249 (1986), interpreting Section 3659, acknowledges that to be exempt, municipal property must be “devoted to public use.” City’s Memo at 2. In fact, the language quoted in the City’s Memo from *City of Montpelier v. Town of Berlin* is taken from *Swanton v. Highgate*, 131 Vt. 318, 322 (1973), which cites to *Stiles* in support of that quote. This demonstrates that Section 3659 coexists with and did not supplant the public use requirement for municipally-owned property.

The City’s Memo also relies on the definitional section of the state education tax laws to dispute the public use requirement. The City cites to 32 V.S.A. § 5401(10)(F), which defines nonresidential property as excluding “[p]roperty owned by a municipality which is located within that municipality and which is used for municipal purposes including the provision of utility services.” From this language it is clear that mere ownership of property by a municipality does not imbue the property with a municipal purpose—otherwise the exclusion would have ended with the phrase “owned by a municipality” and would not have needed the clause “used for municipal purposes.”

Moreover, there is no indication and it is unlikely that the Legislature would have intended to overrule years of common law requiring a public use by simply adding a definition to an entirely separate section of the tax statutes. The

Appendix V AGO memos

exemption in Section 3802(4) for a public, pious or charitable use is found in Chapter 125 of Title 32 specifically covering Exemptions; in contrast, Section 5401(10)(F) is located in Chapter 135 of Title 32 addressing Education Property Tax. *Compare* 32 V.S.A. § 3802(4) with 32 V.S.A. § 5401(10)(F).

Section 5401(10)(F) was added in 1998 as part of Act 71, which made technical corrections to Act 60 of 1997. It was not part of the bills that passed the House or the Senate, but was added during conference committee. See Act Summary for Act 71, available at <http://www.leg.state.vt.us/DOCS/1998/ACTS/ACT071SUM.HTM>; compare Bill as Passed House and Senate to Bill as Passed House and Bill as Passed Senate, available at <http://www.leg.state.vt.us/database/status/summary.cfm?Bill=H%2E0577&Session=1998>. Again, this shows that the Legislature did not intend to overrule the long-standing applicable common law.

While the term “municipal purposes” in Section 5401(10)(F) may arguably be a subset of “public use,” it does not unambiguously overturn the long-standing common law that municipal property must be devoted to a public use to be exempt. It also is not inconsistent with the existing public use requirement nor does it attempt to cover the entire subject matter of municipal exemptions. See *Villeneuve v. Powers*, 158 Vt. 330, 332 (1992) (“The common law is changed by statute only if the statute overturns the common law in clear and unambiguous language, or if the statute is clearly inconsistent with the common law, or the statute attempts to cover the entire subject matter”) (quoting *Langle v. Kurkul*, 146 Vt. 513, 516 (1986)).

The Legislature’s intent is also demonstrated by the unsuccessful attempts to amend Section 5401(10)(F) in 2015 and 2016 to explicitly exclude municipally-owned parking garages. See H.735, sec. 1 (2016 Sess.); Draft Administration Proposals, sec. 8 (2015 Sess.); see also Letter to Finance Committee from Seth Leonard, Mayor of Winooski, dated March 31, 2016. If that is what the Legislature had intended, it would have enacted the proposed language. But it did not, notwithstanding the testimony by Mayor Leonard that otherwise the Winooski parking garage would continue to be subject to taxation.

The City next argues that the parking garage is a VEPC-approved TIF district improvement and the municipality’s legislative body determined it to be of “public interest or necessity,” therefore, the parking garage is put to a public

Appendix V AGO memos

use.¹ Those determinations do not have the same legal standard as an exemption from property taxation. The Vermont Supreme Court has long held that exemptions from taxation must be strictly construed against the party claiming the exemption, with any doubts interpreted against the exemption. *See, e.g., American Museum of Fly Fishing*, 151 Vt. at 108 (“[A]n exemption will be strictly construed against the party claiming it, and any doubts as to its application will be interpreted against the exemption.” (internal citations omitted)).

Moreover, the Tax Increment Finance Districts Adopted Rule (“TIF Rule”) specifically states that the taxation status of a parcel is governed by Vermont property tax law and acknowledges that property built by the municipality and financed with TIF District increment may still be subject to taxation due to the use of the property:

906. Taxation status of a parcel: Whether or not a parcel is subject to the education property tax for purposes of the OTV listing or annual calculation of the increment depends on the Vermont property taxation statute in force at the time of creation of the District for the establishment of the original taxable value and each year thereafter for the valuation of the property in order to calculate the increment. Properties built by the municipality, financed with District increment, or owned by a non-profit may be subject to taxation due to the use of the property or other reasons. Listers/assessors must thoroughly examine Vermont statute and should confer with the Council and Vermont Department of Taxes/PVR regarding any questions regarding the taxation status of a property.

TIF Rule, sec. 906 (adopted May 6, 2015) (available at <https://accd.vermont.gov/sites/accdnew/files/documents/DED/VEPC/Tiff/TIFAdoptedRule05062015.pdf>).

Similarly, that the bond financing did not trigger “private activity bond” problems under Section 141 of the Internal Revenue Code is not determinative of property tax exemption under Vermont law, each of which have different legal standards. While Section 141 may not consider preferential parking

¹ The City references its previous authority to issue bonds for parking lots and meters under Section 1868 of Title 24, chapter 53, subchapter 3 for “Indebtedness for Parking Lots and Meters.” That subchapter was repealed in 2013 and replaced with a more general municipal authority to regulate parking lots and meters in 24 V.S.A. § 2291(26). The previous provision provided that such *bonds* were exempt from taxes; it did not declare the property itself to be exempt from property taxation. *See* 24 V.S.A. § 1868 (repealed) (emphasis added).

Appendix V AGO memos

arrangements with the State of Vermont to be a private use, the perpetual parking arrangement is with a private, for-profit entity, not the state.

Conclusion

Our conclusion, consistent with our opinion with respect to the Winooski parking garage, is that the St. Albans parking garage is subject to and fails the *Fly Fishing* test. The St. Albans parking garage is not unconditionally dedicated to a public use, but rather is primarily committed under two perpetual parking easements, to the exclusion of the public. While the City argues that the parking garage is open to an indefinite class of person—motor vehicle operators—and that the public at large is deemed the beneficiary, the vast majority of the spaces are restricted by the perpetual parking easement agreements and are not available to all motor vehicle operators. The primary use of the property, therefore, is private, benefiting a definite, limited sector of the public. Any benefit to the public is incidental. The garage must also be owned and operated on a not-for-profit basis. The City contends that it remains a public use even though it generates revenue for the City. However, the Court in the *Fly Fishing* case stated that any excess of income over expenses must be derived incidentally from, and not as a deliberate goal of, the operation and must be devoted to the public objective. *American Museum of Fly Fishing*, 151 Vt. at 110. It is not clear if this is the case with the St. Albans parking garage.

Page 5 of 5

Appendix V AGO memos

MEMORANDUM

OFFICE OF THE ATTORNEY GENERAL

TO: Tanya Morehouse, Chief Auditor
FROM: Bill Griffin, Chief Assistant Attorney General
SUBJECT: St. Albans TIF District – “substantial change” questions
DATE: January 3, 2019

Introduction

This is to follow up on our conversations about the State Auditor of Accounts audit of the St. Albans TIF District. You requested guidance from the Attorney General’s Office on two questions:

First, whether St. Albans’ changes to its approved TIF district plan constitute “substantial changes” under 24 V.S.A. § 1901(2)(B) and as described in TIF District Rules Sections 300, 607 and 1003.3.3?

Second, whether the TIF statutes and rules could benefit from clarification of the concept of “substantial change”?

My opinion is that the St. Albans’ changes were “substantial” within the meaning of the statute and rules. As discussed below and in our conversations, the concept of “substantial change” is reasonably clear in the statutes and rules. However, VEPC may want to add a few benchmarks and more process to the VEPC Rule, to underscore the statutory approval requirements for TIF districts.

St. Albans’ TIF District Application and VEPC’s Approval

The City of St. Albans created a TIF District in April 2012, then applied to the Vermont Economic Progress Council (VEPC) for approval to use Education Property Tax Revenue to help finance several projects. The projects described in the St. Albans’ application and the funding sources for those projects were:

1. Taylor Park improvements
TIF debt - \$769,250; Grants - \$160,000; Total - \$929,250
2. Parking Garage
TIF debt - \$8,767,500; Grants - \$0; Total - \$8,767,500
3. Federal Street Connector
TIF debt - \$6,512,389; Grants - \$7,000,000; Total - \$13,512,389

Page 1 of 6

Appendix V AGO memos

4. Street improvements, Phase 2 and Phase 3
TIF debt - \$5,261,255; Grants - \$1,600,000; Total - \$6,861,255
5. Storm Water Treatment
TIF debt - \$1,150,000; Grants - \$0; Total - \$1,150,000
6. Brownfield Clean-up – City Core Site
TIF debt - \$56,546; Grants - \$177,000; Total - \$233,546
7. Brownfield Clean-up – Fonda Site
TIF debt - \$592,982; Grants - \$400,000; Total - \$992,982

In summary, St. Albans proposed to spend \$32.4 million on seven projects using \$23.1 million from TIF debt and \$9.3 million from state and federal grants. The TIF debt financing was expected to cost an additional \$10.6 million, for a total budget of \$43 million.

In August 2012 VEPC approved St. Albans' proposal. VEPC approved \$33,600,000 "for all debt obligations to be financed with incremental property tax revenues ... including the cost of debt financing." See City of St Albans TIF District Application Final Determination letter dated August 30, 2012 at page 29. The Determination letter listed the cost estimates for the seven projects, the funding sources (TIF debt and grants) for each project and the TIF debt financing costs. *Id.* at page 7.

VEPC's Determination letter included some qualifying language. VEPC determined that both the TIF District Plan and the TIF Financing Plan were approved "as presented" and "to the extent that a determination can be made at the time of application." *Id.* at page 27. VEPC noted the challenge of "infrastructure cost estimating" as well as St. Albans' "reliance on ... federal and state grants and parking revenue to maintain a positive revenue flow for the TIF District" *Id.* at 28. In light of these uncertainties VEPC instructed the City to include certain financial information in annual reports to VEPC and to provide a revised Financial Plan to VEPC prior to March 31, 2017. *Id.* at page 28.

In November of 2012, St. Albans voters approved \$43,000,000 in spending to support the development and financing plans approved by VEPC.

The Auditor of Accounts Performance Audit

As required by statute, 32 V.S.A. § 5404a(l), the Auditor of Accounts is conducting a performance audit of the St. Albans TIF District. The purpose of this audit is to determine compliance with the TIF statutes and rules. The Auditor's preliminary findings are that St. Albans' plans have changed in several respects since the City presented those plans to VEPC and to St. Albans' voters.

Page 2 of 6

Appendix V AGO memos

First, work on the Taylor Park, expected to be done in 2013, has not started.

Second, work on the Parking Garage has been completed, but at a cost of \$10,197,564 – about \$1,430,000 or 16% over the estimate.

Third, work on the Federal Street Connector, expected to be completed in 2014, was suspended. The City spent about \$500,000 on some intersection work, but this represents just 4% of the total expenditures planned for this project. The City has not yet managed to obtain the federal grants needed to do the bulk of the work.

Fourth, the street improvements expected to begin in 2014 and 2015 are in progress. The expenses to date are about \$4,800,000 and the work may be as much as 70% complete.

Fifth, the Storm Water Treatment work, expected to be completed in 2015, has not started.

Sixth, Brownfield work on the downtown block was completed at a cost of \$715,121 – about \$480,000 over the estimate. The City paid the entire \$715,121 using TIF debt, \$658,575 more than the \$56,546 estimate for TIF debt.

Seventh, Brownfield work on the Fonda property, estimated to be done in 2014 at a cost of \$992,982, has not started.

In addition to the seven projects presented to VEPC in 2012, the Auditor's tentative findings show that St. Albans used \$1,400,000 in TIF debt to purchase a site for an ACE hardware store and an additional \$300,000 to remediate the site. The City sent an email to VEPC staff requesting approval to use TIF funds to remediate the site and VEPC staff agreed that this change would not need VEPC's approval.

The "substantial change" statutes, policies and rules

In 2012, when VEPC approved St. Albans' TIF application, VEPC had a written policy that required municipalities to obtain prior approval for any "substantial change" to the plans described in Final Determination letters. See TIF District Substantial Change Policy and Procedure, Version 3 (2012) at page 2. First, proposed changes had to be "considered and approved" by the local legislative body. *Id.* Then, based on a letter signed by local officials and on documents supporting the proposed changes, VEPC had to decide to whether allow or deny the change. *Id.*

VEPC's 2012 policy defined "substantial change" generally and listed examples of changes considered "substantial." *Id.* at page 1. The general definition cited changes not consistent with the plan approved locally or by VEPC. *Id.* Examples of substantial changes included:

Page 3 of 6

Appendix V AGO memos

adding properties, eliminating or adding infrastructure improvements, and adding substantial cost to an infrastructure project. *Id.* Changes causing “a material change to fiscal viability of less than 20%” could be approved by VEPC staff and simply reported to the VEPC board. *Id.* at page 2.

In 2013, the Legislature added the phrase “substantial change” to the TIF definitions statute, 24 V.S.A. § 1891, and to the TIF reporting statute, 24 V.S.A. § 1901. *See* Public Acts, 2013 Session, No. 80, §§ 2 and 10. Neither the Act nor the related statutes define “substantial change.”

The definitions statute, as amended, provides that certain payments for municipal improvements, if not included in the financing plan approved by VEPC, are considered “a substantial change” subject to the VEPC review process. *See* 24 V.S.A. § 1891(7). The VEPC review process is described in the TIF reporting statute. The reporting statute, as amended, provides that municipalities shall, “as required by events ... submit any proposed substantial changes to be made to the approved tax increment district plan and approved financing plan to the Council for review” 24 V.S.A. § 1901(2)(B). So, the 2013 statutory changes tracked the 2012 VEPC policy and required both local and VEPC approval of substantial changes to TIF plans.

In May 2015, VEPC adopted a rule that defined “substantial change” and established procedures to be followed by municipalities proposing substantial changes to their TIF plans. The rule defined “substantial change” as an amendment to an approved plan that “may result in a significant impact with respect to any of the criteria” specified in the TIF statutes. *See* VEPC Rule #15-PO4, Section 300 at p. 7. These criteria favor, for example, projects likely to remediate and develop brownfields or to improve traffic patterns and flow. *See* 32 V.S.A. § 5404a(h)(4)(C) and (E). The rule distinguishes “substantial changes” from “minor changes” – which must be reported to but not approved by VEPC. *See* VEPC Rule #15-PO4, Section 607 at page 12.

Consistent with the 2012 VEPC policy and the 2013 legislation, VEPC’s 2015 rule requires local and VEPC approval of substantial changes to TIF plans. The municipality proposing substantial changes to an approved plan must hold a public hearing, obtain approval from the municipal legislative body and then file a change request with VEPC. *See* VEPC Rule #15-PO4, Section 1003.3.3 at page 35. VEPC allows or denies change requests considering, for example, the impact of proposed changes on the fiscal viability of the district, on education property tax revenues and on the overall objectives of the district. *Id.* at page 36.

Appendix V AGO memos

Discussion

There may be some distinctions between the 2012 VEPC policy and the 2015 VEPC rule as they define “substantial change” in a TIF context. Given the effective dates of the policy and rule, and the intervening date when St. Albans’ TIF application was approved by VEPC, one could argue which of the two definitions should be emphasized. The lack of a statutory definition suggests only that the phrase should be given its ordinary meaning – that is, a change that is considerable, significant or important.

VEPC itself used the ordinary meaning of “substantial change” in its policy and in its rule. The VEPC *policy* adopted 20% as the financial threshold for changes that require VEPC approval.¹ The VEPC *rule* speaks of “changes that may result in a significant impact” and changes that are not “minor.”²

The constant theme of the TIF statute, rule and policy is that TIF plans must be approved by VEPC. As VEPC emphasized in the St. Albans’ determination letter – VEPC can only approve or reject a TIF application “as presented.” See Determination letter at page 28. When the plans change in a significant or “substantial” way, the municipality must notify VEPC and obtain VEPC’s approval of the changed plans.

The SAO’s preliminary findings identify several substantial changes in St. Albans TIF plans and financings. The changes are substantial by several measures.

First, the number of projects is smaller than planned. Four of the original seven projects have been postponed indefinitely or cancelled. The Taylor Park improvements, expected to be completed in 2013, have not started. Work on the Federal Street Connector, expected to be completed in 2014 to remove “a major hindrance to development” in downtown St. Albans, has

¹ The Legislature used 10% as the “substantial change” threshold for changes in municipal projects covered by Vermont’s land use statutes. See 10 V.S.A. § 6081(d). For example, permits are not required when the change does not expand the capacity of a wastewater treatment or water supply facility by more than ten percent. *Id.* Permits are not required when a school project does not expand the student capacity by more than ten percent. *Id.* Permits are not required when building projects do not expand the floor space by more than ten percent. *Id.*

² The “significant impact” language in the VEPC Rule tracks Rule 5.408a of the Vermont Public Utilities Commission. A companion rule – Rule 5.409 – imposes a reporting requirement on utilities when the costs of a project increase by 20%. The Commission Rules and the meaning of “substantial change” were the subject of a recent decision by the Vermont Supreme Court. See *In re Petition of Conservation Law Foundation*, 2018 VT 42. The Court decided that the phrase and the Rules were subject to “two reasonable interpretations” and accepted the Commission’s ruling that, in the circumstances, a cost overrun greater than 20% was not necessarily a “substantial change.” *Id.* at ¶ 17.

Appendix V AGO memos

been suspended. The Storm Water Treatment work planned for 2015, also essential to downtown development projects, has not started. The Fonda Brownfield clean-up, expected to be done in 2014 so that multi-family housing could be constructed on the site, has not been started.

Second, the financial plan has changed significantly. The 2012 plan assumed \$7 million in federal grants and \$13.5 million in total spending for the Federal Street Connector. Without these grants the TIF District budget will be reduced from \$43 million to less than \$30 million. Despite the reduced scope of work the City has already committed \$23 million of TIF funds (\$16 million borrowed plus \$7 million in interest) of the \$34 million authorized. Also, there may be shortfalls in anticipated revenues from the parking garage.

Third, the use of the TIF debt proceeds has changed. Your tentative findings indicate that the City spent \$10.2 million of TIF funds on the parking garage - \$1.4 million (16%) more than planned. The City spent \$715,000 of TIF funds on the Core Brownfield clean-up, \$658,000 more than the \$57,000 that was planned and approved. The City spent \$1.7 million on the ACE hardware project – a project that was not in the original plan.

All of these considerations, if confirmed upon completion of the audit, would demonstrate a substantial change in the St. Albans' TIF District that would require review by VEPC and approval of an amended plan consistent with current circumstances.

Finally, as discussed, there might be some value in a rule change that added benchmarks and process to the VEPC Rule. For example, the Rule's definition of "substantial change" could list percentage or dollar amounts or events that would trigger reporting requirements. The Rule could expand on the current reporting procedures for "substantial changes" and "minor corrections." More information would be needed to determine what rule changes – if any – would be useful.

Appendix V AGO memos

MEMORANDUM

OFFICE OF THE ATTORNEY GENERAL

TO: Tanya Morehouse, Chief Auditor
FROM: Bill Griffin, *[Signature]*, Assistant Attorney General
SUBJECT: St. Albans TIF District – use of bond proceeds to pay debt service
DATE: February 7, 2019

Introduction

This is to follow up on our conversations about the State Auditor of Accounts audit of the St. Albans Tax Incremental Financing (TIF) District. You requested guidance from the Attorney General's Office on several questions. The immediate question is whether the TIF statutes allow TIF district bond proceeds to be used to pay the debt service on those bonds. My opinion is that the statutes do not allow bond proceeds to be used for that purpose.

The TIF Statutes

The statutes that govern Tax Increment Financing are codified in Title 24, Chapter 53, Subchapter 5. These statutes authorize municipalities to create special districts known as "tax increment financing" districts. 24 V.S.A. § 1892(a). The purpose of these districts is "to provide revenues for improvements that serve the district and [for] related costs" 24 V.S.A. § 1893. The goal is to "stimulate development or redevelopment within the district, provide for employment opportunities, improve and broaden the tax base or enhance the general economic vitality of the municipality, the region, or the State." *Id.*

The premise of Tax Increment Financing is that economic development will generate a "tax increment" from new and improved properties in TIF districts. 24 V.S.A. § 1896(a). The statutes authorize municipalities to retain a portion of these additional taxes "for financing improvements and related costs...." 24 V.S.A. § 1896(d). The taxes retained by municipalities include a percentage of the education property tax increment – taxes that would otherwise be owed to the Education Fund. See 24 V.S.A. § 1894(b).

Subchapter 5 grants municipalities specific authority to borrow for TIF projects. A municipality "may incur indebtedness against revenues of the tax increment financing district...." 24 V.S.A. § 1894 (a)(1). A municipality may issue "general obligation bonds, revenue bonds, or revenue bonds also backed by the municipality's full faith and credit ... to finance the undertaking of any improvements wholly or partly within [the TIF] district." 24 V.S.A. § 1898(b).

Page 1 of 3

Appendix V AGO memos

Subchapter 5 defines “improvements” to mean “the installation, new construction, or reconstruction of infrastructure that will serve a public purpose and fulfill the purpose of tax increment financing districts” 24 V.S.A. § 1891(4). The listed examples of improvements that qualify for TIF financing are “utilities, transportation, public facilities and amenities, land and property acquisition and demolition, and site preparation.” *Id.* Also, as discussed in my August 9, 2018 memorandum, Subchapter 5 and Rules promulgated under that Subchapter provide that TIF debt may be used to finance “related costs” as defined by 24 V.S.A. § 1891(6).

Thus, Subchapter 5 provides a complete description of the TIF program. It explains the purpose of the program, the financing arrangements that are allowed and the rules that govern the use of tax revenues and bond proceeds. “The powers conferred by [Subchapter 5] are supplemental and alternative to other powers conferred by law, and this subchapter is intended as an independent and comprehensive conferral of powers to accomplish the purposes set forth herein.” 24 V.S.A. § 1898(a).

Discussion

My understanding is that St. Albans submitted a TIF district application to the Vermont Economic Progress Council (VEPC) in 2012. The application documents stated that the City would issue bonds to finance improvements and that all debt proceeds would be used for that purpose. This plan was consistent with 24 V.S.A. § 1898(b) (municipality may issue bonds to finance the undertaking of improvements), and the VEPC approved the application.

The issue now is whether TIF bond proceeds may be used to pay expenses other than “improvements” and “related costs” as those terms are defined in Subchapter 5. The City, through its legal counsel, acknowledges that the Subchapter 5 definition means that bond proceeds must be spent on infrastructure, public facilities, land and other “hard, tangible assets” of the sort listed in 24 V.S.A. § 1891(4). The City nevertheless argues that this definition is not controlling – that it should not be “read in a vacuum” – and that TIF bond proceeds may be used for “all manner of soft costs” including the funding of reserves to pay debt service on the bonds.

In support of its argument for an expansive reading of “improvements” the City cites to a definition in Title 24, Chapter 53, Subchapter 1. Subchapter 1 deals with municipal debt generally and defines improvements to mean something “apart from its ordinary signification.” 24 V.S.A. § 1751(3)(A). This definition is broader than the tangible assets definition that applies to TIF debt. For example, the Subchapter 1 list of “improvements” that may be financed using bond proceeds includes “the funding of reserves.”

Appendix V AGO memos

The City argues that TIF bond proceeds may be used for all of the purposes listed in the general debt statute as well as for the narrower purposes listed in the TIF statute. The City assumes that that was the legislative intent. Therefore, according to the City, TIF bond proceeds can be used to fund reserves and to pay the debt service on TIF bonds.

My view is that the Legislature intended to treat TIF bonds as a special category of debt subject to special rules. This is evident from the text of the "improvements" definition in Subchapter 5, which is quite specific and obviously narrower than the definition in Subchapter 1. If the Legislature intended to allow TIF bond proceeds to be used for a broad category of "improvements," including debt service, it could have used the broad language that it used in Subchapter 1. Or, it could have cross-referenced the Subchapter 1 definition of "improvements" and made it applicable to TIF debt. The Legislature did neither. Rather, it enacted a different and narrow definition of improvements when it enacted Subchapter 5 (the TIF subchapter).

Also, the Legislature took unusual care to establish a special rule of construction for Subchapter 5. As noted above, Subchapter 5 "is intended as an independent and comprehensive conferral of powers to accomplish the purposes set forth herein." 24 V.S.A. § 1898(a). The plain meaning of the TIF statutes should not be compromised based on definitions that appear in other subchapters in the debt statutes.

To be clear, this opinion is limited to the use of bond proceeds, and does not apply to the use of tax revenues. The Legislature expressly authorized municipalities to "hold apart" the incremental tax revenues realized in TIF districts and to use a portion of those revenues to pay "related costs." 24 V.S.A. § 1896(a) and (d). "Related costs" are defined as "expenses incurred and paid by the municipality, exclusive of the actual cost of constructing and financing improvements, that are directly related to the creation and implementation of the tax increment financing district, including reimbursement of sums previously advanced by the municipality for these purposes." 24 V.S.A. § 1891(6). The municipal tax increment – but not the education tax increment – may also be used to cover certain direct municipal expenses.

Please let me know if you have related questions.

Thank you.

Page 3 of 3

Appendix VI

Comments from Management

The following is a reprint of management's response to a draft of the report we provided for comment. As required by GAGAS, we provide our evaluation of the comments in Appendix VII.

Management's Comments Related to SAO Report

Introduction

The ability to form strong partnerships with the State of Vermont is an essential skill for local government managers. Strong partnerships produce successful projects; successful projects attract resources for the next project. An essential ingredient for successful projects is the ability to follow the rules.

Over the last five years, the City of St. Albans has formed a strong partnership with the State of Vermont through the Vermont Economic Progress Council (VEPC). We have kept VEPC informed and up to date on how our projects have developed and, when necessary, sought their formal approval. The City of St. Albans has followed the rules.

At all times, the City has relied in good faith on the applicable regulations, rules and procedures known to it. The City now finds itself charged with failing to comply with standards and mandates not found in any official guidance.

In government, we follow strict procedural requirements for changing the rules. This principle balances the enforcement powers that the government enjoys. Yet this report advances alternate interpretations of long-standing rules and practices – changes that threaten the viability of TIF districts across the State -- without any of the procedural requirements associated with wholesale rule changes that impact millions of dollars of investment based on the existing rules.

Of the 70 plus assertions in this report, there is not one requirement that our lawyers and consultants have not previously considered, evaluated, and advised. Their advice was not alternative or ground breaking; it was mainstream interpretations of tax increment finance as applied in Vermont for the last 20 years. In another context, one would describe the Auditor's proposed application of the rules as grounds for a breach of contract action.

But the ability to form strong partnerships is an essential skill for local government managers. Our quarrel is not with the State of Vermont as a whole, it is solely with the State Auditor's Office (SAO). We are confident we can reach swift resolution with the agencies of jurisdiction.

Notwithstanding the political grand standing that permeates this report, the SAO has four questions and we have four answers.

1. Were the City's improvements to the hotel site permitted within the TIF program as authorized by VEPC?

The City followed the plain meaning of the definition of *improvements* which explicitly authorize our actions. The City regularly updated VEPC with the latest information we had, as recently as February of 2019. VEPC has never had any concerns with the site improvements completed for the hotel. We have filed the paperwork for a final resolution with VEPC and await their determination.

2. Can working capital reserve funds be utilized and can TIF's reimburse funds advanced on its behalf if it has the funds to do so?

Appendix VI

Comments from Management

A working capital reserve fund is funds that are borrowed in excess of what is needed for the project to help service the debt until the increment is created. It is a ubiquitous public finance tool. Its use is part of the answer to the TIF approval criterion of *need*.

In the TIF application, communities must demonstrate that they cannot complete the public improvements without the TIF program; therefore, they often need some form of short-term borrowing. This aligns well with the general understanding that TIF's can reimburse funds advanced once the increment materializes. The suggestion that this tool cannot be used and those funds cannot be reimbursed through the TIF is in direct conflict with the purpose of tax increment financing, which is founded upon the nexus of public and private development projects.

3. Is there any taxable value to the parking garage and, if so, should the City true up the financials?

The City has ordered an independent appraisal and will work with the Tax Department to resolve any valuation issues.

4. Did the voters fully understand this was a 20-year commitment?

It is difficult to see how they could not. The City held extensive hearings and published thorough explanations, all of which contained in depth explanations of the 20-year repayment plan. The City prides itself on the transparency of financial reporting that is necessary to inspire and maintain public confidence. Nonetheless, the City Council has ratified any irregularities related to the call of the meeting so this is a moot point. The bonds passed by a large margin, with 559 voting *yes* 170 voting *no*.

In the pages below, the City demonstrates that we followed the rules that were in effect during the last five years and have already commenced resolution of any technical issues with the agencies of jurisdiction. In addition, we demonstrate that the SAO has exceeded its statutory authority; attempted to overturn long standing legal interpretations; and attempted to convert arcane, technical questions into headline grabbing sound bites.

Performance and Compliance

The Legislature charged the Auditor with conducting a performance audit. Performance audits are supposed to focus on outcomes. They are designed to answer the question, "Are we getting our money's worth?"

St. Albans' outcomes are off the charts: a \$52 million addition to the statewide grand list; a 65 percent increase in tax revenues in five years; and construction of a downtown hotel, parking garage, and award-winning streetscape that had been sitting on shelves *since 1981*.

During this same five-year period, the State Education Fund received \$660,000 in additional revenue the fund would not have received if the St. Albans TIF program were not in place. VEPC is projecting a 98 percent increase in Education Fund proceeds from St. Albans over the life of the TIF. A 98 percent increase in revenues with zero percent of the risk is a pretty good return on investment.

Appendix VI

Comments from Management

St. Albans has demonstrated how the State of Vermont can partner with local communities to strengthen rural Vermont and grow the education fund. We have demonstrated how to add good jobs and stabilize our education and municipal taxes. The *performance* of the St. Albans TIF is very strong. The State of Vermont is absolutely getting a positive return from the investments in the St. Albans TIF.

Instead of judging us by our performance the Auditor has conducted a compliance audit. Compliance audits focus on process. They are designed to answer the question, "Did you follow the rules?"

The City closely followed the rules as they were communicated and understood by VEPC. We sought extensive advice from multiple attorneys and consultants with the requisite experience in the field. Time and time again we circled back to VEPC and inquired if our actions required additional approval from VEPC. They never required additional approval. Every point offered by the auditor's office had been reviewed by our own counsel, and by VEPC.

During the Audit, we became aware of the alternate interpretations of long-standing practices being advanced by the Auditor. These were novel interpretations of TIF statutes that upended 20 years of practice in the field. Five years into our program, the Auditor was proposing to change the rules of the game.

In response, we proactively applied to VEPC to affirm our understanding and await its final interpretation. This filing is available at www.stalbanvt.com.

The City believes the SAO exceeded its statutory authority when it unilaterally determined to conduct a compliance audit instead of a performance audit; the agency of jurisdiction has never identified any compliance issues with the City.

The venue for the report's alternate interpretations of the TIF statutes and rules is the Statehouse and the rulemaking process. Accusing the City of unauthorized use of funds is purposefully incendiary and serves a policy objective of discrediting the TIF program. There is little evidence to support these claims and evidence to the contrary has been conveniently overlooked.

Eligibility of Hotel Development Costs

The report asks two questions regarding the hotel development. The first question is if brownfield and site improvement costs for the hotel are eligible for TIF expenses. The suggestion is that because the cleanup and site improvements were performed on property that was ultimately transferred to the hotel and not a public entity, they may not be eligible.

This interpretation is inconsistent with the statutory premise of TIF, namely the nexus between public improvements and private projects. The TIF statute defines improvements as "the installation, new construction, or reconstruction of infrastructure that will serve a public purpose and fulfill the public purpose of tax increment financing districts ... including utilities, transportation, public facilities and amenities, land and property acquisition and demolition, and site preparation." The public purpose is the economic development and tax base growth envisioned by a TIF. It is hard to imagine a broader, more expansive definition and it aligns well with the nexus between public and private projects that is the essence of TIF.

Appendix VI

Comments from Management

The report also questions expenses for site preparation costs. The same definition of *improvements* is at play and specifically authorizes site preparation costs. During the pre-development phase, a site investigation revealed that some of the soils were characterized as “urban” and would need to go to a landfill and others, while not contaminated, would not support the loads of a 4-story building. This is common in urban redevelopment sites where the soils are comprised of diverse material. In these instances, clean fill must be brought in and the grades must be set according to the design and structural load of the new structure.

Based on the above definition for improvements, the City agreed to support the hotel project by addressing both the contaminated and the non-load bearing soils, all of which fit well within the definition of improvements and were necessary to make our urban site competitive with a greenfield site. We also note that any substantial building located on this site would have the same issue with urban soils.

A second question is whether the TIF statutes allow for a brokerage fee to be utilized as a form of payment for professional services. The City paid its primary real estate development consultant White and Burke a \$100,000 brokerage fee at the successful conclusion of the hotel transaction. This was in lieu of consulting fees, which would be paid regardless of whether we landed a hotel or not. The TIF statutes define *related costs* as “expenses, exclusive of the actual cost of constructing and financing improvements, that are directly related to the creation and implementation of the tax increment financing district.” 24 VSA Section 1891(6).

The advice we have received from White and Burke is one of the most essential elements of our program. Whether we pay this as a brokerage fee or an hourly rate is immaterial to the nature and function of the expense. It is hard to imagine an expense that is *more* directly related to the creation and implementation of the district than a brokerage fee paid upon completion of our largest source of increment.

Tax Status of Parking Garage

When the TIF was approved, the single largest public project was a parking garage. None of our projections included a tax liability and neither VEPC or the third-party evaluators suggested that it should. Nor should they have. Construction of a public parking garage to allow adjacent private development is the quintessential public/private partnership envisioned by the TIF statute. Why would a public parking garage, approved as part of a state economic development program, owned and operated by the municipality, not be tax exempt?

The taxable value has already been captured in the buildings’ appraisal. Suggesting that the City also must pay property tax is the proverbial “double dip.”

The two largest sources of increment on the private side are the office building and the hotel. Without construction of the parking garage, the hotel and the office buildings could not be completed. Without protecting their rights to park through deeded rights to the garage, these buildings could not be financed.

The Report suggests that by vesting those parking rights converts the garage into a taxable entity. The City has a solid legal foundation upon which its tax exemption is based. But exemption is different than value and there may be little value to litigate.

Appendix VI

Comments from Management

During the Audit the City agreed to have an independent appraisal of the garage using the income-based method. We agreed to open up a settlement discussion with the State Tax Department once the value is established. Since the operating expenses exceed the revenues by over \$500,000 per year, it is hard to imagine a large value.

It is not a question of cost recovery of lost funds. It is an arcane question about whether there is any taxable value for a publicly owned garage that loses hundreds of thousands of dollars per year and can only be paid for through tax increment finance.

This finding should reflect the true state of affairs among the parties and not the inflammatory assertion that was printed.

Repayment of Funds Advanced Using Increment

A common challenge in TIF districts is how to address the revenue shortfall in the first few years after the public improvements have been made but before the private investments have completed. Because the public improvements, by design, incent the private investment, TIFs are inherently back loaded. St. Albans chose to borrow a little more money than was needed for just improvements and use those funds to service the debt in the first five years. We called those funds a *working capital reserve* because they were intended to flow out in the first years of the TIF and be replenished (flow in) in the subsequent years. The working capital reserve was approved by our bond counsel, was featured prominently in our public information sessions, and was approved through the underwriting process with the Vermont Municipal Bond Bank. For a copy of this document, visit www.stalbansvt.com.

At the February 2019 VEPC meeting, VEPC approved our use of the working capital reserve and applied a condition that they be replenished by continuing at 100 percent of municipal increment. Since that meeting, the Report has asserted that funds advanced on behalf of a TIF cannot be replenished by the TIF in successive years if the TIF is able to. This assertion turns the TIF program on its head.

TIFs have always been analyzed over the life of the district – the 20-year retention period. Indeed, VEPC's viability analysis that was performed in our 2012 application and was recently affirmed during the February approval, all use the full retention period as the basis for the analysis. The assertion that funds advanced on behalf of a TIF cannot be repaid using increment converts the TIF program from a 20-year program to a year-by-year program. This is a 180 degree turn from the way TIFs have always been administered by VEPC and understood by municipal attorneys and development consultants.

The report points to the language in 24 VSA 1894(i), which states that if the tax increment is insufficient to pay the principal and interest, in any year, the municipality remains liable for the full payment of the principal and interest for the term of indebtedness. This has always been interpreted through the lens of a 20-year program and to mean that the annual debt requirements never fell back on the education fund. Municipalities willingly accepted this condition as it reflected the inherent back loading of TIF districts. Municipalities are willing to accept the risk because they are utilizing a long-term strategy to expand the tax base for the community. It is unlikely municipalities would be willing to front the money if it couldn't be repaid over time through increment.

Appendix VI

Comments from Management

Finally, it should be noted that at the time of St. Albans advancement of funds on behalf of the TIF, communities only had five years to issue all the debt for the TIF. It has since been expanded to ten. The five-year period created tremendous pressure to hit the ground running and advance the cash that was necessary to make the projects happen, lest the community waste the incredible opportunity offered by a TIF. This aligns well with the understanding and advice communities received that they had to front the funds, but they could be replenished if the TIF was successful.

This finding and the associated recommendations should be disregarded. It is wholly inconsistent with the purpose of the program.

Voter Education

The Report asserts that the City did not place enough emphasis on the term of the bonds and voters may not have understood what they were voting on. This assertion does not hold up to scrutiny. The City has never invested *more* heavily in the transparency and public outreach surrounding a bond vote. We used traditional methods such as public hearings, presentations at Rotary, and informal lunch meetings with small groups of citizens. And we used nontraditional methods such as social media and weekly newspaper columns. We were criticized locally for spending too much emphasis explaining the vote and how the working capital reserve rose and fell over the 20-year life of the TIF.

In all of the presentations, we reviewed our financial model. We were (and are) proud of its conservative projections and numerous safety valves. In all of these presentations, we displayed 20 years of prospective financials. We displayed spreadsheets and PowerPoint slides showing how the TIF fund rose and fell over a 20-year term. This document is available at www.stalbansvt.com.

Therefore, on April 1, 2019, the City Council ratified any procedural defects associated with the call of the meeting. We forwarded this to VEPC for their approval under the substantial change process. We are waiting for VEPC's determination at the end of May.

This is a narrow issue concerning what voters did or did not understand, rendered obsolete the City Council's ratification.

Once again, the Report should reflect the true state of affairs among the parties and not assert that St. Albans failed to disclose matters to the voters. The vote passed by a more than three to one margin in a special election.

Conclusion and Counter Recommendations

A great deal of public resources has been expended in this effort. For nearly a year, the Auditor has relentlessly pursued red herrings. Ultimately, the SAO released findings that can easily be addressed by the agencies of jurisdiction. The questions raised are the daily grist of inter-agency accounting and reporting.

They are akin to a new supervisor asking new questions about an old program. They are hardly worthy of the terms "Unauthorized Use," "Understatement of Increment", and "St. Albans Owes Education Fund" that was plastered on the title. All of the money is accounted for. There are no allegations of misappropriations.

Appendix VI

Comments from Management

It is unfortunate that one of the transactional costs of a TIF is enduring the State Auditor's efforts to discredit the program and those who use it. The Auditor will undoubtedly assert that his office is a team of professionals following professional standards that are subjected to a rigorous peer review process. That assertion is not mutually exclusive of the City's assertion that the Auditor's policy perspective on economic development programs influences the analysis that is performed.

In politics, as in life, where you stand depends on where you sit. The Auditor has made it clear where he stands on TIF districts - and this was clear before the audit was performed - and the Legislature should amend the statute for TIF audits to provide that these audits are performed by independent auditors instead.

Notwithstanding the uninspiring experience of the State Audit, the St. Albans TIF was the greatest thing to happen to our community since the Railroad. We would do it all again in a heartbeat.



Dominic Cloud
St. Albans City Manager
May 6, 2019

Appendix VII

SAO Evaluation of Management's Comments

St. Albans' Management Response	SAO Comment
<p><i>"Over the last five years, the City of St. Albans has formed a strong partnership with the State of Vermont through the Vermont Economic Progress Council (VEPC)..."</i></p>	The City Manager asserts that VEPC is a partner, but according to statute and the TIF Rules VEPC is the entity charged with determining whether to approve a municipality's request to use education tax increment for repayment of TIF district debt, conducting oversight and monitoring, and assisting with non-compliance enforcement.
<p><i>"At all times, the City has relied in good faith on the applicable regulations, rules and procedures known to it. The City now finds itself charged with failing to comply with standards and mandates not found in any official guidance.</i></p> <p><i>In government, we follow strict procedural requirements for changing the rules. This principle balances the enforcement powers that the government enjoys. Yet this report advances alternate interpretations of long-standing rules and practices - changes that threaten the viability of TIF districts across the State -- without any of the procedural requirements associated with wholesale rule changes that impact millions of dollars of investment based on the existing rules.</i></p> <p><i>During the Audit, we became aware of the alternate interpretations of long-standing practices being advanced by the Auditor. These were novel interpretations of TIP statutes that upended 20 years of practice in the field. Five years into our program, the Auditor was proposing to change the rules of the game.</i></p> <p><i>The venue for the report's alternate interpretations of the TIP statutes and rules is the Statehouse and the rulemaking process."</i></p>	Our audit did not apply standards or mandates not found in official guidance and did not advance alternative interpretations of long-standing rules and practices for TIF districts. We applied requirements in state statute and the TIF Rules to the St. Albans TIF district and in some instances found that St. Albans did not comply with the requirements. We requested guidance from the AGO regarding certain statutory provisions and TIF Rules and used this guidance to conclude on St. Albans' compliance. For example, St. Albans treated the parking garage as tax exempt, but the AGO concluded that the parking garage was taxable. The AGO reached the same conclusion in 2012 for Winooski's parking garage and pointed out in its guidance relative to St. Albans' parking garage that the two attempts to amend statute in 2015 and 2016 to explicitly exclude municipally owned parking garages from taxation were unsuccessful as the legislature declined to amend statute for this exemption.

Appendix VII

SAO Evaluation of Management's Comments

St. Albans' Management Response	SAO Comment
<p><i>"Of the 70 plus assertions in this report, there is not one requirement that our lawyers and consultants have not previously considered, evaluated, and advised. Their advice was not alternative or ground breaking; it was mainstream interpretations of tax increment finance as applied in Vermont for the last 20 years."</i></p>	<p>The conclusions in the audit are based upon analyses conducted. Our audit was conducted in accordance with GAGAS, which contains requirements and guidance to assist auditors in objectively acquiring and evaluating sufficient, appropriate evidence and reporting the results. The City Manager alleges that the advice of the City's lawyers and consultants was a mainstream interpretation of tax increment financing as applied in Vermont for the last 20 years. However, the TIF statutes have not been static during this period. Act 80 of 2013 introduced changes to the TIF statutes, such as: lengthening the time period that municipalities may issue debt, requiring a public vote for each debt issuance and specifying the requisite disclosures to voters, submitting proposed substantial changes to VEPC for review, capping the percent of education tax increment at 75 percent, and requiring an equal share of municipal tax increment to service the TIF debt. In addition, the TIF Rules, issued May 6, 2015, provide guidance for what is an improvement or related costs, among other clarifications. Furthermore, we sought the advice of the AGO in multiple instances. See Appendix V.</p>

Appendix VII

SAO Evaluation of Management's Comments

St. Albans' Management Response	SAO Comment
<p><i>"Notwithstanding the political grand standing that permeates this report, the SAO has four questions and we have four answers."</i></p> <p>Question 1: <i>"Were the City's improvements to the hotel site permitted within the TIF program as authorized by VEPC?"</i></p> <p><i>The City followed the plain meaning of the definition of improvements which explicitly authorize our actions. The City regularly updated VEPC with the latest information we had, as recently as February of 2019. VEPC has never had any concerns with the site improvements completed for the hotel. We have filed the paperwork for a final resolution with VEPC and await their determination."</i></p>	<p>The definition of improvements and other factors impact whether costs incurred are eligible for TIF district financing.</p> <p>Requirement</p> <p>A. A municipality must submit a TIF district plan and a TIF financing plan (i.e., TIF application materials) to VEPC and receive approval from VEPC for the improvements and related costs as presented in the application materials.</p> <p>St Albans TIF District</p> <p>A. Based on information in the City's TIF district application and VEPC's Final Determination, SAO concluded that core brownfield as approved by VEPC was limited to brownfield remediation activities and most of the hotel-related costs were not brownfield remediation activities.</p> <p>Requirement</p> <p>B. Voters must be informed of the improvements and related costs to be financed with TIF debt before voting on whether a municipality may issue TIF district debt.</p> <p>St. Albans TIF district</p> <p>B. The materials provided to voters, minutes from public hearings held in advance of the Sept. 2013 public vote, materials on the City's website, and newspaper articles provided by the City all stated that the TIF debt would be used for "brownfield clean-up" and did not disclose that TIF debt would be used to pay for site preparation costs on behalf of a private hotel development project.</p> <p>Requirement</p> <p>C. The costs must meet the definition of improvements or related costs in statute and the TIF Rules.</p> <p>St Albans TIF District</p> <p>C. Neither 24 V.S.A. §1891(4) or TIF rule 704 address whether paying site preparation or other costs on behalf of a specific private development project are eligible improvement costs that may be financed with TIF district debt. However, a VEPC FAQ states the "the cost of the direct infrastructure a developer needs for completion of their project is borne by the developer."</p> <p>Regardless of whether the costs meet the definition of related costs or improvements, they were not included in the description of the core brownfield in the City's application materials. Further, the costs weren't described in the materials made available in advance of the public vote to authorize TIF district debt financing for brownfield clean-up at the hotel site. Therefore, SAO concluded the costs were not eligible to be financed with TIF district debt.</p>

Appendix VII

SAO Evaluation of Management's Comments

St. Albans' Management Response	SAO Comment
<p>Question 2: "Can working capital reserve funds be utilized and can TIF's reimburse funds advanced on its behalf if it has the funds to do so?"</p> <p><i>A working capital reserve fund is funds that are borrowed in excess of what is needed for the project to help service the debt until the increment is created. It is a ubiquitous public finance tool. Its use is part of the answer to the TIF approval criterion of need.</i></p> <p><i>In the TIF application, communities must demonstrate that they cannot complete the public improvements without the TIF program; therefore, they often need some form of short-term borrowing. This aligns well with the general understanding that TIF's can reimburse funds advanced once the increment materializes. The suggestion that this tool cannot be used and those funds cannot be reimbursed through the TIF is in direct conflict with the purpose of tax increment financing, which is founded upon the nexus of public and private development projects."</i></p>	<p>A. St. Albans used approximately \$1 million of the TIF debt proceeds to pay for debt service on the TIF debt. The City's attorney argues that this use falls within the definition of improvements in 24 V.S.A., Chapter 53, Subchapter 1 and is an allowed use of TIF district debt. The AGO's opinion is that the TIF statutes do not allow TIF bond proceeds to be used for this purpose. The AGO advised that while the general municipal bonding statute includes the use bond proceeds to fund reserves in the definition of improvement (Title 24 Chapter 53 Subchapter 1), the TIF statutes' definition of improvements is much narrower (Title 24 Chapter 53 Subchapter 5). Further, the AGO noted that if the legislature had intended to allow TIF bond proceeds to be used for a broad category of improvements, including debt service, it could have used the broad language that it used in Subchapter 1. As the AGO concluded, using TIF debt to pay debt service on TIF debt is not an improvement within the definition established by the legislature in the TIF statutes (Title 24, Chapter 53, Subchapter 5) and is not allowed.</p> <p>B. The City states that the use of a working capital reserve fund "is part of the answer to the TIF approval criterion of need" and that "communities must demonstrate that they cannot complete public improvements without the TIF program; therefore, they often need some form of short-term borrowing." We reviewed the City's TIF Cash Flow schedule, provided to VEPC in June 2012 during the TIF application process, and noted that it did not disclose that 1) the City anticipated a significant shortfall in resources needed to pay TIF debt or 2) the City anticipated using TIF debt proceeds to pay debt service on TIF debt. Rather, the City's projections showed that tax increment plus parking fees from the parking garage would be sufficient to cover debt repayments with the exception of 2014 when the projections show a shortfall of \$18,830.</p> <p>C. We did not state that funds advanced on behalf of a TIF cannot be repaid with tax increment. Rather, we concluded that the City's use of TIF debt to pay debt service of TIF debt was not considered an improvement and therefore, not an allowed use of TIF district debt. When we learned that St. Albans intended to use tax increment to replace the debt funds that were used to pay debt service, we became concerned about the City's potential repayment timeline and whether its intent to use tax increment in this manner is allowed by statute. Accordingly, we requested guidance from the AGO about whether tax increment may be used to replace the debt funds that were used to pay debt service. As of the date of the report, this issue remains open.</p>

Appendix VII

SAO Evaluation of Management's Comments

St. Albans' Management Response	SAO Comment
<p>Question 4: "Did the voters fully understand this was a 20-year commitment?</p> <p><i>It is difficult to see how they could not. The City held extensive hearings and published thorough explanations, all of which contained in depth explanations of the 20-year repayment plan. The City prides itself on the transparency of financial reporting that is necessary to inspire and maintain public confidence. Nonetheless, the City Council has ratified any irregularities related to the call of the meeting so this is a moot point. The bonds passed by a large margin, with 559 voting yes 170 voting no."</i></p>	<p>In its TIF presentation, used at the 8/26/2013 and 9/9/2013 public meetings, the City provided an example of the life of a TIF district. The example shows a 30-year bond to finance infrastructure investment where payments would extend for 10 years beyond the 20-year period that tax increment may be retained. The presentation did not address the repayment term for the bonds the voters were asked to approve and the minutes for the meetings held on 8/26/2013 and 9/9/2013 do not reflect that the term was disclosed.</p> <p>The City states that "City Council has ratified any irregularities related to the call of the meeting, so this is a moot point." The resolution passed by City Council on 4/1/2019 does not disclose the repayment term of the bond and the meeting minutes do not reflect that the repayment term was discussed.</p>
<p><i>"In addition, we demonstrate that the SAO has exceeded its statutory authority..."</i></p>	<p>The City Manager is mistaken. 32 V.S.A. §5404a(l) requires that SAO conduct performance audits of all TIF districts. According to this provision, the audits shall include a review of municipal adherence to relevant statutes and rules adopted by VEPC, an assessment of record keeping related to revenues and expenditures, and a validation of the portion of the tax increment retained by the municipality and used for debt repayment and the portion directed to the Education Fund. Our audit objectives address these requirements.</p>
<p><i>"In addition, we demonstrate that the SAO has...attempted to convert arcane, technical questions into headline grabbing sound bites."</i></p>	<p>Our audit findings are not based on arcane, technical questions. For example, we considered whether St. Albans used TIF district debt for eligible improvements and related costs and concluded that the City's use of approximately \$1 million of TIF debt to pay debt service on TIF debt was not allowed under the TIF statutes and that the City used TIF debt for more than \$400,000 of costs incurred on behalf of a private hotel development that were beyond the brownfield remediation improvement approved by VEPC and municipal voters.</p>

Appendix VII

SAO Evaluation of Management's Comments

St. Albans' Management Response	SAO Comment
<p><i>“Performance and Compliance”</i></p> <p><i>The Legislature charged the Auditor with conducting a performance audit. Performance audits are supposed to focus on outcomes. They are designed to answer the question, "Are we getting our money's worth?"</i></p> <p><i>"Instead of judging us by our performance the Auditor has conducted a compliance audit. Compliance audits focus on process. They are designed to answer the question, "Did you follow the rules?"</i></p>	<p>The City's definition of performance audit does not reflect the statutory requirements for TIF district audits and is incorrect. SAO conducts performance audits in accordance with generally accepted government auditing standards (GAGAS) issued by the United States Government Accountability Office. These standards define performance audits as those that provide findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits with compliance audit objectives are an assessment of compliance with criteria such as those established by provisions of laws, regulations, contracts, or grant agreements.</p> <p>32 V.S.A. §5404a(l) requires that SAO conduct performance audits of all TIF districts. According to this provision, the audits shall include a review of municipal adherence to relevant statutes and rules adopted by VEPC.</p>
<p><i>"Time and again we circled back to VEPC and inquired if our actions required additional approval from VEPC."</i></p> <p><i>"Every point offered by the Auditor's office had been reviewed...by VEPC."</i></p>	<p>The City provided documentary evidence that a city official or consultant consulted with the then VEPC Executive Director about two brownfield remediation improvements that were not in the TIF application and regarding an overdue revised financial plan.</p> <p>The City did not provide evidence that it consulted with VEPC prior to the SAO audit regarding the use of TIF debt to pay debt service on TIF debt. Further, in the substantial change request the City submitted in January 2019, the City did not explicitly address this issue. Rather, the City included this use under the heading "Voter-authorized debt, not yet spent." Subsequent to inquiry from SAO about whether the TIF debt used to pay debt service on TIF debt was included in this heading, the City submitted revised materials and asked VEPC to approve this use of TIF debt. In addition, the City did not provide evidence that it informed VEPC the core brownfield improvement would include site preparation and other costs incurred on behalf of a private hotel development.</p>

Appendix VII

SAO Evaluation of Management's Comments

St. Albans' Management Response	SAO Comment
<p><i>"In response, we proactively applied to VEPC to affirm our understanding and await its final interpretation."</i></p>	<p>The City's January 10, 2019 request for substantial change was in response to SAO's identification of St. Albans' changes to its TIF district plan and the AGO guidance which indicated a substantial change had occurred. The City Manager indicates in correspondence to VEPC about the request, "there is nothing substantial in this substantial change."</p> <p>The City's second request for substantial change, dated April 18, 2019, was also submitted as a result of the audit and requests that VEPC approve the instances of use of TIF district debt that SAO concluded was unauthorized and the City's proposal to utilize tax increment to remedy the unauthorized use of TIF debt to pay debt service on TIF debt which SAO raised concern about. TIF Rule 1102 addresses issue resolution and non-compliance enforcement and requires decisions to be issued by the Secretary of the Agency of Commerce and Community Development. This section does not indicate that the substantial change process, which is addressed in TIF Rule 1003.3.3 and is under the Council's authority, may be used by the Council to consider non-compliance or inquiries concerning the administration of TIF districts, statutes, or rules.</p>
<p><i>"The City believes the SAO exceeded its statutory authority when it unilaterally determined to conduct a compliance audit instead of a performance audit..."</i></p>	<p>SAO did not unilaterally determine to conduct a compliance audit. 32 V.S.A. §5404a(l) requires that TIF district audits include a review of municipal adherence to relevant statutes and rules adopted by VEPC. As a result, our audit objectives incorporate assessing St. Albans' compliance with TIF statutes and TIF Rules. As noted previously, performance audits include compliance.</p>

Appendix VII

SAO Evaluation of Management's Comments

St. Albans' Management Response	SAO Comment
<p><i>"Accusing the City of unauthorized use of funds is purposefully incendiary and serves a policy objective of discrediting the TIF program. There is little evidence to support these claims and evidence to the contrary has been conveniently overlooked."</i></p>	<p>As noted previously, SAO is statutorily required to conduct audits of TIF districts. The audit objectives incorporate the elements established in statute that are required to be addressed in the audit. There is no policy objective to discredit the TIF program.</p> <p>The City does not specify the evidence it claims SAO overlooked in its findings and conclusions and it's clear the City Manager is upset about the audit findings. However, our audit was conducted in accordance with GAGAS, which contains requirements and guidance to assist auditors in objectively acquiring and evaluating sufficient, appropriate evidence and reporting the results.</p> <p>Appendix I, Scope and Methodology, explains the evidence reviewed by SAO and the analysis conducted.</p>
<p><i>"The report asks two questions regarding the hotel development. The first question is if brownfield and site improvement costs for the hotel are eligible for TIF expenses. The suggestion is that because the cleanup and site improvements were performed on property that was ultimately transferred to the hotel and not a public entity, they may not be eligible."</i></p> <p><i>"The report also questions expenses for site preparation costs. The same definition of improvements is at play and specifically authorizes site preparation costs."</i></p> <p><i>"We also note that any substantial building located on this site would have the same issue with urban soils."</i></p>	<p>The City mischaracterized SAO's conclusion regarding costs associated with the hotel site. We did not question the eligibility of brownfield costs associated with the hotel site. Specifically, we concluded that \$73,944 of \$604,946 of hotel costs (as classified by the City in its Summary of TIF expenses), were eligible to be financed with TIF debt as the costs were for core brownfield cleanup or streetscape. For \$4,443 classified as hotel costs, the City's documentary evidence was not sufficient to determine if the costs related to a VEPC-approved infrastructure improvement or qualify as a related cost.</p> <p>We concluded that \$426,559 of the costs classified by the City as hotel costs were not authorized to be financed with TIF debt because 1) the costs were not included in the description of the costs for the core brownfield improvement in the TIF district plan approved by VEPC and 2) the documentary evidence related to the September 2013 bond vote does not indicate that voters were explicitly informed that the brownfield clean-up at the hotel would include costs such as site improvements for the benefit of the hotel development. For the remaining \$100,000, a brokerage fee that the City contends is a related cost, we concluded it is not clear that these costs are considered related costs because costs associated with a private development project are not explicitly addressed in statute or TIF Rules.</p> <p>We also concluded that \$267,883 of costs classified by the City as "construction, garage, and site" were for core brownfield remediation and were eligible to be paid with TIF district debt.</p>

Appendix VII

SAO Evaluation of Management's Comments

St. Albans' Management Response	SAO Comment
<p><i>"A second question is whether the TIF statutes allow for a brokerage fee to be utilized as a form of payment for professional services. The City paid its primary real estate development consultant White and Burke a \$100,000 brokerage fee at the successful conclusion of the hotel transaction. This was in lieu of consulting fees, which would be paid regardless of whether we landed a hotel or not. The TIF statutes define related costs as "expenses, exclusive of the actual cost of constructing and financing improvements, that are directly related to the creation and implementation of the tax increment financing district." 24 VSA Section 1891(6).</i></p> <p><i>The advice we have received from White and Burke is one of the most essential elements of our program. Whether we pay this as a brokerage fee or an hourly rate is immaterial to the nature and function of the expense. It is hard to imagine an expense that is more directly related to the creation and implementation of the district than a brokerage fee paid upon completion of our largest source of increment."</i></p>	<p>First, we did not question the form of payment; we questioned whether a fee paid to a consultant for the sale of a property to a private developer was an eligible related cost. We noted that the definition of related costs in the TIF Rules and the examples provided do not address whether municipal costs for professional services associated with private development qualify as related costs.</p> <p>Second, the City states that White & Burke was paid a \$100,000 brokerage fee in lieu of consulting fees which would have been paid regardless of whether the City landed a hotel or not. We note that the City paid White & Burke consulting fees, in addition to the brokerage fee, for services associated with the sale of the property to the private developer. A White & Burke invoice dated November 15, 2015 describes the following services: review of draft investment agreement for hotel, negotiate with the developer, attend meetings about the investment agreement. It also includes charges for preparing a letter to the Development Review Board to request the Board reconsider its decision regarding the hotel.</p>
<p><i>"When the TIF was approved, the single largest public project was a parking garage."</i></p>	<p>According to VEPC's 2012 approval (Final Determination), the City's largest public infrastructure improvement was the Federal Street Multi-Modal improvement with estimated costs of \$13,512,389. The parking garage was estimated at \$8,767,500.</p>
<p><i>"Why would a public parking garage, approved as part of a state economic development program, owned and operated by the municipality, not be tax exempt?"</i></p> <p><i>"The Report suggests that by vesting those parking rights converts the garage into a taxable entity. The City has a solid legal foundation upon which its tax exemption is based."</i></p>	<p>The AGO concluded that the garage was taxable and advised that "the Legislature's intent is also demonstrated by the unsuccessful attempts to amend Section 5401(10)(F) in 2015 and 2016 to explicitly exclude municipally-owned parking garages. If that is what the Legislature had intended, it would have enacted the proposed language." See Appendix V, for the AGO memo related to the tax status of the parking garage.</p>

Appendix VII

SAO Evaluation of Management's Comments

St. Albans' Management Response	SAO Comment
<p><i>"During the Audit the City agreed to have an independent appraisal of the garage using the income-based method. We agreed to open up a settlement discussion with the State Tax Department once the value is established. Since the operating expenses exceed the revenues by over \$500,000 per year, it is hard to imagine a large value.</i></p> <p><i>It is not a question of cost recovery of lost funds. It is an arcane question about whether there is any taxable value for a publicly owned garage that loses hundreds of thousands of dollars per year and can only be paid for through tax increment finance."</i></p>	<p>The City provided VEPC a copy of its FY2020 parking program budget, and this document shows that total actual annual expenditures for the entire city parking program ranged from \$65,066 to \$211,074 during the period FY2015 to FY2018. In addition, this document shows that revenues exceeded expenditures in each year. Regardless, according to the VDT Lister and Assessor Handbook, for the income approach to property valuation, the income and expense figures should come from the market, not simply from the subject.</p> <p>With regard to the City's belief that it can settle with VDT, we are not aware of VDT authority to negotiate a settlement, and PVR informed us that any adjustment in the valuation of the parking garage would be part of the City's inventory on April 1, 2019 and take effect in grand list 2019. The City's board of abatement has the authority to abate statewide education property taxes. However, if a board abates statewide educational property taxes, the municipality is still obligated to the State for the full amount of statewide educational taxes due.</p>
<p>RE: parking garage assessed value</p> <p><i>"This finding should reflect the true state of affairs among the parties and not the inflammatory assertion that was printed."</i></p>	<p>Our finding is not an inflammatory assertion; it is based on financial data of the City. As described in the audit report, SAO utilized the value of the parking garage included in the city-certified abstract of the grand list, required to be submitted annually to the PVR division of VDT, to estimate the amount of tax increment generated by the parking garage. Based on this calculation, SAO estimated the amount of tax increment that should have been allocated to the TIF district and the amount owed to the state Education Fund.</p>
<p><i>"A common challenge in TIF districts is how to address the revenue shortfall in the first few years after the public improvements have been made but before the private investments have completed. Because the public improvements, by design, incent the private investment, TIFs are inherently back loaded."</i></p>	<p>As we noted previously, the City's TIF Cash Flow projection, submitted during the TIF application process in June 2012, showed that tax increment plus parking garage fees would be sufficient to cover debt repayments with the exception of 2014 when the projection showed a shortfall of \$18,830. Further, we reviewed audited financial statements for four municipalities with active TIF districts approved by VEPC after 2006 and did not find evidence that these municipalities used TIF debt to pay debt service of TIF debt.</p>

Appendix VII

SAO Evaluation of Management's Comments

St. Albans' Management Response	SAO Comment
<p><i>"At the February 2019 VEPC meeting, VEPC approved our use of the working capital reserve and applied a condition that they be replenished by continuing at 100 percent of municipal increment. Since that meeting, the Report has asserted that funds advanced on behalf of a TIF cannot be replenished by the TIF in successive years if the TIF is able to. This assertion "turns the TIF program on its head."</i></p> <p><i>The assertion that funds advanced on behalf of a TIF cannot be repaid using increment converts the TIF program from a 20-year program to a year-by-year program. This is a 180 degree turn from the way TIFs have always been administered by VEPC and understood by municipal attorneys and development consultants.</i></p> <p><i>The report points to the language in 24 VSA 1894(i), which states that if the tax increment is insufficient to pay the principal and interest, in any year, the municipality remains liable for the full payment of the principal and interest for the term of indebtedness. This has always been interpreted through the lens of a 20-year program and to mean that the annual debt requirements never fell back on the education fund. Municipalities willingly accepted this condition as it reflected the inherent back loading of TIF districts. Municipalities are willing to accept the risk because they are utilizing a long-term strategy to expand the tax base for the community. It is unlikely municipalities would be willing to front the money if it couldn't be repaid over time through increment."</i></p> <p><i>"This finding and the associated recommendations should be disregarded. It is wholly inconsistent with the purpose of the program."</i></p>	<p>According to the Executive Director, a letter has not been sent to St. Albans following VEPC's approval of the City's January 2019 substantial change request on the matter of whether TIF debt may be used to pay debt service for TIF debt and how the VEPC repayment condition may be implemented has been held for further review by VEPC. Per the Executive Director, as part of deciding on these issues, VEPC intends to review the audit findings, the City attorney's legal opinion, and the guidance provided to the SAO by the AGO. VEPC has sought further guidance from the AGO and the Agency of Commerce and Community Development's legal counsel. VEPC also plans to hear from St. Albans and other interested parties at the May 30, 2019 VEPC meeting.</p> <p>St. Albans misstated our conclusion. We did not assert that funds advanced on behalf of a TIF cannot be repaid with tax increment, and our report does not point to 24 V.S.A. §1894(i) in this context. Rather, based on AGO guidance, we concluded that the City's use of TIF debt to pay debt service on TIF debt was not considered an improvement, and therefore, not an allowed use of TIF district debt.</p>

Appendix VII

SAO Evaluation of Management's Comments

St. Albans' Management Response	SAO Comment
<p><i>"Finally, it should be noted that at the time of St. Albans advancement of funds on behalf of the TIF, communities only had five years to issue all the debt for the TIF. It has since been expanded to ten. The five-year period created tremendous pressure to hit the ground running and advance the cash that was necessary to make the projects happen, lest the community waste the incredible opportunity offered by a TIF. This aligns well with the understanding and advice communities received that they had to front the funds, but they could be replenished if the TIF was successful."</i></p>	<p>First, St. Albans did not execute an "advancement of funds on behalf of the TIF." Rather, the City used TIF district debt to make debt service payments on this same debt.</p> <p>Second, by June 2013 (10 months after VEPC issued its Final Determination approving St. Albans use of tax increment to repay TIF district debt), the TIF statutes had been amended and municipalities approved by VEPC could use education tax increment to repay debt issued during the five years following the creation of the district and if debt were issued within the first five years, then the municipality had a total of ten years to incur debt (24 V.S.A. §1894(a)(1) and 24 V.S.A. §1894(3)(b)). St. Albans issued its first bonds in January 2014, within the first five years of creation of the TIF district, and as a result had ten years to issue debt, not the five years the City claims created tremendous pressure to advance cash to make projects happen.</p>

Appendix VII

SAO Evaluation of Management's Comments

St. Albans' Management Response	SAO Comment
<p><i>"For nearly a year, the Auditor has relentlessly pursued red herrings. Ultimately, the SAO released findings that can easily be addressed by the agencies of jurisdiction. The questions raised are the daily grist of inter-agency accounting and reporting.</i></p> <p><i>They are akin to a new supervisor asking new questions about an old program. They are hardly worthy of the terms "Unauthorized Use," "Understatement of Increment," and "St. Albans Owes Education Fund" that was plastered on the title. All of the money is accounted for. There are no allegations of misappropriations."</i></p>	<p>The conclusions in the audit are based upon analyses conducted. Our audit was conducted in accordance with GAGAS, which contains requirements and guidance to assist auditors in objectively acquiring and evaluating sufficient, appropriate evidence and reporting the results.</p> <p>The report title is based on the audit findings and conclusions.</p> <p>For example, St. Albans used TIF debt to repay TIF debt, which is not allowed according to AGO guidance. The TIF district plan and TIF district finance plan reviewed and approved by VEPC did not include a working capital reserve or the intent to use TIF debt proceeds to pay debt service on TIF debt. An update of the TIF district provided by the City to VEPC in March 2018 did not disclose that the City was using TIF debt to pay debt service on TIF bonds. As a result, St. Albans use of TIF debt to pay debt service on TIF bonds was not authorized. We also concluded that some of the costs classified by the City as hotel costs were not authorized to be financed with TIF debt because 1) the costs were not included in the description of the costs for the core brownfield improvement in the TIF district plan approved by VEPC and 2) the documentary evidence related to the September 2013 bond vote does not indicate that voters were explicitly informed that the brownfield clean-up at the hotel would include costs such as site improvements for the benefit of the hotel development.</p> <p>In another example, St. Albans treated the parking garage as tax exempt, excluding it from the calculation of tax increment. As a result, education and municipal tax increment was understated and St. Albans owes the TIF district its share of the understated amount and the Education Fund its share of the understated amount.</p>

Appendix VII

SAO Evaluation of Management's Comments

St. Albans' Management Response	SAO Comment
<p><i>"It is unfortunate that one of the transactional costs of a TIF is enduring the State Auditor's efforts to discredit the program and those who use it. The Auditor will undoubtedly assert that his office is a team of professionals following professional standards that are subjected to a rigorous peer review process. That assertion is not mutually exclusive of the City's assertion that the Auditor's policy perspective on economic development programs influences the analysis that is performed."</i></p>	<p>The City Manager is dismissive of the fact that the SAO is staffed by a team of professionals following professional standards whose work is subject to rigorous peer review. The standards we follow in all our audits, GAGAS, provide a framework for conducting high quality audits with competence, integrity, objectivity, and independence. Further, GAGAS contains requirements and guidance to assist auditors in objectively acquiring and evaluating sufficient, appropriate evidence and reporting the results. These standards are used by local, state, federal, and international government and private audit organizations. Our performance audits are subject to peer review by other state's auditors and in our latest peer review conducted in 2018, we received the highest rating attainable.</p> <p>The City Manager asserts that the elected State Auditor's policy perspective on economic development programs influenced the analysis that was performed. We strongly disagree with the City Manager's assertion, as the standards we follow are designed to prevent this from occurring. In addition, we note that audit staff performed TIF audits under a prior elected State Auditor and found significant compliance issues in other TIF districts.</p>

Appendix VIII

Comments from VEPC

The following is a reprint of VEPC's response to a draft of the report we provided for comment. As required by GAGAS, we provide our evaluation of the comments in Appendix IX.



Vermont Economic Progress Council
Agency of Commerce and Community Development
6th Floor, Deane C. Davis State Office Building
1 National Life Drive, Montpelier, VT 05620-0501

Monday, May 13, 2019

The Honorable Douglas R. Hoffer, State Auditor
132 State Street
Montpelier, VT 05633-5101

Dear Mr. Hoffer,

The Vermont Economic Progress Council (VEPC) thanks you for the opportunity to offer management comments and thanks your staff for their professional demeanor throughout the Saint Albans Tax Increment Finance (TIF) audit process.

VEPC convened a special meeting of the Council on May 7, to enable Council members and staff to assess the findings and recommendations of the Saint Albans TIF District five-year Performance Report Draft Audit. As an Independent Board, the Council believes it is important to maintain its independence in these comments and chose not to invite outside parties to stay for the Executive Session as only the Auditor and not Auditee was present.

There are important points in this report that VEPC will study in the next several months and make determinations on. Indeed, all the recommendations to VEPC are areas that we will review and update. The Council welcomes constructive dialog with the State Auditor's Office on a range of topics to be reviewed and acted upon in the Council's coming monthly meetings and summer retreat. These topics include, but are not limited to:

- a clearer definition of when a substantial change request is needed,
- the use of TIF debt proceeds to pay debt before increment occurs,
- related costs,
- how the Council and State Auditor collaborate in developing clearer guidelines

The authority entrusted to VEPC to administer Vermont's TIF Program is one that the Council takes seriously. We work closely with Vermont's TIF municipalities to ensure use of State Education Fund incremental dollars complies with statute and TIF Rule. The Council's role in administration is one of assisting Districts in their compliance through review of related materials, frequent communication, monitoring visits, and the use of a substantial change process and enforcement.

As you know, TIF is a complex program that has undergone several statutory revisions in its history. These revisions have informed VEPC's role in TIF as well as the rules and expectations

Appendix VIII

Comments from VEPC



Vermont Economic Progress Council
Agency of Commerce and Community Development
6th Floor, Deane C. Davis State Office Building
1 National Life Drive, Montpelier, VT 05620-0501

prescribed to TIF Districts. At times they have also, as cited in the SAO report, led to confusion about process and expectations. If this confusion causes errors or omissions, it is important that relevant State entities work constructively with Districts to ensure tax funds are appropriately used and support the best chance of success for our communities.

The Saint Albans Audit and the Draft Report identified items for VEPC to review. The review has already begun with the submission of a Substantial Change Request by Saint Albans in January of 2019. Questions have also been raised that affect all Districts and the administration of the program.

Outside of the report content the Council believes that the tone of the audit report's current draft title does not embody a constructive approach. It appears to pronounce a verdict or judgment, where the governing authorities on these matters have not yet made one. The report's draft title, "*Unauthorized Use of TIF District Debt and Understatement of Tax Increment; Saint Albans Owes TIF District and State Education Fund*" encourages a negative perspective from the onset. It is contrary to the core values described in the Vermont State Auditor's Professional Standards Manual (PSM), namely, "The working relationship developed with the audited agency or department is important to any audit's success." And "Auditors must be aware that they have an analytic, not policy making, role. With this understanding, audits and audit reports are fair, objective, and unbiased."

Such a title does not align with the conclusions and recommendations in the report, which prescribe VEPC take actionable steps to provide clarification and review compliance.

Following this letter, please find the Council's observations pertaining to specific sections of this report where VEPC believes its perspective is merited.

On behalf of the Vermont Economic Progress Council,

John Davis,
Chair
Vermont Economic Progress Council

Megan Sullivan,
Executive Director
Vermont Economic Progress Council

Appendix VIII

Comments from VEPC



Vermont Economic Progress Council
Agency of Commerce and Community Development
6th Floor, Deane C. Davis State Office Building
1 National Life Drive, Montpelier, VT 05620-0501

VERMONT ECONOMIC PROGRESS COUNCIL-SAINT ALBANS TIF DISTRICT PERFORMANCE AUDIT DRAFT REPORT, MANAGEMENT COMMENTS

Having been requested by the State Auditor to provide Management Comments on the Saint Albans TIF District Performance Audit Draft Report, VEPC offers the following comments on certain report findings and the recommendations for VEPC.

Background

We find it useful to provide additional information on the Saint Albans TIF District performance as it relates to the full statutory definition of the purpose of Vermont's TIF program.

24 V.S.A. § 1893- Purpose

The purpose of tax increment financing districts is to provide revenues for improvements that serve the district and related costs, which will stimulate development or redevelopment within the district, provide for employment opportunities, improve and broaden the tax base, or enhance the general economic vitality of the municipality, the region, or the State.

Saint Albans applied to VEPC after years of a stagnant grand list. Without growth in a grand list there is likely an increase in the tax rate for citizens to keep funding whole. The use of TIF combined with the work of the Saint Albans city's staff, City Council and the citizens of Saint Albans, the city has been able to reverse that trend; between the 2012 and 2017 grand list years, there has been a 45.4% increase in the TIF District grand list.

The Saint Albans TIF District became active in 2013 and its measurable outcomes go beyond costs and benefits to the Education Fund and reflect directly on the purpose statement in Statute. This program has enabled a more vibrant and economically sound anchor downtown in Vermont's Northwest quadrant. There have been considerable transportation enhancements, and remediation and redevelopment of brownfield sites that have stimulated private development and provided employment opportunities and greater economic vitality.

The cost to the Education Fund referred to in this report citing a report by Vermont's Joint Fiscal Office provides incomplete analysis of how TIF works, which the Council communicated at the time that report was issued. The assertion that private development would have happened regardless of TIF, is not shared by this Council. The Council has studied this program and its participating Districts in great detail. When a TIF District is established, the Original Taxable Value of the parcels in that District is frozen. That means that the Education Fund will not receive any less money than that Original Taxable Value. Even if values fall, the State Education Fund will remain whole. As private development occurs following the public investments financed through TIF, a portion of the new development's tax increment will be

Appendix VIII

Comments from VEPC



Vermont Economic Progress Council
Agency of Commerce and Community Development
6th Floor, Deane C. Davis State Office Building
1 National Life Drive, Montpelier, VT 05620-0501

added to that Original Taxable Value, thereby increasing the amount going to the Education Fund each year.

Objective 1: TIF Financed Eligible Infrastructure Improvement Costs and Related Costs but also Funded Unauthorized Uses (Pages13-29)

Core Brownfield expenditures

At VEPC's July 28, 2012 meeting in which the project criteria for this District were approved it was moved and approved by VEPC in regards to the Core Brownfields project that, "at least one of the proposed redevelopment projects will cause the remediation and redevelopment of that site, and therefore, Project Criterion C, is met." This criterion states that:

- 32 V.S.A. § 5404a(4) (C) The project will affect the remediation and redevelopment of a brownfield located within the district. As used in this section, "brownfield" means an area in which a hazardous substance, pollutant, or contaminant is or may be present, and that situation is likely to complicate the expansion, development, redevelopment, or reuse of the property.

Redevelopment work done on a brownfield area in addition to remediation is an eligible TIF use and one that VEPC approved. However, the Council will, as recommended to the Saint Albans City Manager in this report, work with the District to review the specific redevelopment improvements and related costs incurred through the Core Brownfield project for this hotel site to ensure compliance with statute and rule. Any compliance deviations will be corrected.

Substantial Changes to 2012 TIF District Plan

As this report outlines, Saint Albans submitted a revised financing plan through the Substantial Change process to VEPC in January of 2019. The request was approved by VEPC in February of 2019. This revised financing plan outlined the changes in costs and timeline of projects approved for the Saint Albans TIF District, all of which remained under the initial approved debt ceiling of \$23 million. The city has requested additional review by the Council through this process for determinations of issues raised in this report.

The parameters for a Substantial Change Request and clarity of that process are items that the Council will work to address through the rule-making review process (already underway) with initial reviews and recommendations being drafted by Council staff and ACCD Counsel.

TIF debt proceeds used to make debt payments

Title 24 on Municipal Government and Title 32 on Taxation and Finance both address TIF. In the five-year audit of the Saint Albans TIF, the State Auditor's Office requested and received

Appendix VIII

Comments from VEPC



Vermont Economic Progress Council
Agency of Commerce and Community Development
6th Floor, Deane C. Davis State Office Building
1 National Life Drive, Montpelier, VT 05620-0501

advice from the Attorney General's Office about a TIF District's use of debt proceeds from a TIF bond to pay debt service on the same. The opinion and resulting guidance were limited only to interpretation of the Title 24 statutes authorizing municipalities to incur debt – one set on general debt not connected to TIF and another on financing VEPC-approved TIF projects. It did not address the TIF's rationale or intention for using debt proceeds while waiting for increasing grand list values to generate sufficient increment to cover the payments. However, a number of applicable statutes in Title 32 bear directly on TIF and strongly suggest that a different answer is possible.

Chapter 135 of Title 32 on Education Property Tax lays out the entire approval process assigned to VEPC for the establishing TIF Districts and approving projects therein. In the broader context of VEPC's duties to administer the statewide TIF program, Chapter 135 provides significant substantive and procedural requirements, decision-making criteria, and comprehensive rulemaking authority to provide clarification and detail for administering the TIF program.

VEPC asked the Attorney General Office to consider key Chapter 135 provisions including VEPC's duty to apply the "but for" test, the April 1 demarcation for grand list determination, and the authorization for municipalities to use increment during the full retention period. 32 VSA 5404a(f) in pertinent part broadly provides, "*Any use of education property tax increment approved [by VEPC] ... shall remain available to the municipality for the full period authorized....*" (emphasis added).

VEPC's request highlighted the practical impediment to paying debt service in the first years of the retention period when a TIF project has yet to benefit from an increase in annual April 1 grand list determinations to generate sufficient increment to fully cover the early debt service payments. Delayed access to tax increment would not cause a net cost increase to the municipality where the municipality used bond proceeds to pay TIF debt in the beginning.

A broader look at this issue considering the controlling statutes in Chapter 135 would provide essential advice to VEPC. The Council is considering this issue from the perspectives of opinions issued by all relevant parties and the intent of Titles 24 and 32 in aggregate.

Objective 3 FY2017 TIF District Debt Payments an Eligible Use of Tax Increment (Pages 34-35)

City's compliance with Public Notice Requirements Prior to Obtaining Voter Approval
As this finding relates to the oversight by VEPC, staff will continue to assist all TIF Districts on public notification requirements and tracking through the recordkeeping process. An internal checklist is now provided proactively to Districts to help them meet all requirements.

Appendix VIII

Comments from VEPC



Vermont Economic Progress Council
Agency of Commerce and Community Development
6th Floor, Deane C. Davis State Office Building
1 National Life Drive, Montpelier, VT 05620-0501

Recommendations to VEPC

Three of the Recommendations in this report ask VEPC to make clarifications in the TIF Rule.

The TIF Rule was created in accordance with Statute in 2015. It provides more detailed guidance in areas that were not made fully clear in Statute. After four years of administering this rule, we concluded that there is a need for further clarification and improved guidance to TIF Districts and to the Council.

VEPC has been reviewing all sections of the TIF Rule with the Tax Department's Property Valuation and Review staff. Once this initial review is complete, VEPC will engage the TIF Districts and other partners and go through the Rule Making process for public input and adoption. The areas for recommendation will be considered during this process so that we can best serve the Districts as stewards of State tax dollars.

Regarding the FAQ document: While there is value in having a FAQ section available on our website, such a document does not have any legal bearing. The Council therefore will look at the recommendation in context of the TIF Rule update and will adjust the FAQ document to harmonize with any determinations made through that rule making process.

Appendix IX

SAO Evaluation of VEPC Comments

VEPC Response	SAO Comment
<p><i>"At times they have also, as cited in the SAO report, led to confusion about process and expectations. If this confusion causes errors or omissions, it is important that relevant State entities work constructively with Districts to ensure tax funds are appropriately used and support the best chance of success for our communities."</i></p>	<p>VEPC infers that there has been confusion about process and expectations. However, the City has not attributed the issues we identified to confusion on their behalf. For the majority of the findings identified during the audit, the City disagrees with the report conclusions.</p>
<p><i>"Outside of the report content the Council believes that the tone of the audit report's current draft title does not embody a constructive approach."</i></p>	<p>The report title is critical of St. Albans' implementation of its TIF district, but the title is based on the audit findings and conclusions, as required by GAGAS.</p> <p>For example, St. Albans used TIF debt to repay TIF debt, which is not allowed according to AGO guidance. This use of debt proceeds was not part of the TIF district Plan approved by VEPC in August 2012. As a result, St. Albans use of TIF debt to pay debt service on TIF bonds was not authorized and we recommended that the City repay the TIF Capital Projects Fund.</p> <p>In another example, St. Albans treated the parking garage as tax exempt, excluding it from the calculation of tax increment. As a result, education and municipal tax increment was understated and St. Albans owes the TIF Debt Service Fund its share of the understated amount and the Education Fund its share of the understated amount.</p>
<p><i>"It appears to pronounce a verdict or judgment, where the governing authorities on these matters have not yet made one."</i></p>	<p>It's not clear why VEPC believes SAO may not conclude about municipal compliance with statute and rules prior to the governing authorities' review.</p> <p>Statute requires SAO to audit all TIF districts and that the audits include review of municipal adherence to relevant statutes and rules adopted by VEPC. In addition, 32 V.S.A. §5404a(j)(2)(A) lists noncompliance identified in SAO audit reports as one of the items on which the Secretary of Commerce and Community Development has authority to issue decisions and TIF Rules 1001 and 1103 indicate that VEPC will provide the Secretary with a recommendation. There is nothing in the statute provisions or the rules that suggest SAO must wait for a governing authority's decision before concluding on compliance.</p>

Appendix IX

SAO Evaluation of VEPC Comments

VEPC Response	SAO Comment
<p><i>"It is contrary to the core values described in the Vermont State Auditor's Professional Standards Manual (PSM), namely, "The working relationship developed with the audited agency or department is important to any audit's success." And "Auditors must be aware that they have an analytic, not policy making, role. With this understanding, audits and audit reports are fair, objective, and unbiased."</i></p>	<p>SAO believes it is possible to have disagreements and maintain professional working relationships with audited entities. The two are not mutually exclusive.</p> <p>VEPC provided no evidence that SAO was unfair and biased. The conclusions in the audit are based upon analyses conducted. Our audit was conducted in accordance with GAGAS, which contains requirements and guidance to assist auditors in objectively acquiring and evaluating sufficient, appropriate evidence and reporting the results. Scope and Methodology in Appendix I describes the procedures SAO performed.</p>
<p><i>"Such a title does not align with the conclusions and recommendations in the report, which prescribe VEPC take actionable steps to provide clarification and review compliance."</i></p>	<p>The recommendations to VEPC are necessarily different than the recommendations for St. Albans because we did not audit VEPC's compliance with statute and the TIF Rules. In addition, 32 VSA 5404a(j) and TIF Rule 1100 address the process to be used by VEPC to consider questions of statutory and rule interpretation and noncompliance by TIF districts, so we concluded it wasn't necessary to direct VEPC to follow-up on the St. Albans audit findings.</p>

Appendix IX

SAO Evaluation of VEPC Comments

VEPC Response	SAO Comment
<p><i>"Redevelopment work done on a brownfield area in addition to remediation is an eligible TIF use and one that VEPC approved. However, the Council will, as recommended to the Saint Albans City Manager in this report, work with the District to review the specific redevelopment improvements and related costs incurred through the Core Brownfield project for this hotel site to ensure compliance with statute and rule. Any compliance deviations will be corrected."</i></p>	<p>Subsequent to receipt of VEPC's comments on the draft report, SAO requested that the VEPC Executive Director provide documentary evidence that shows VEPC approved the use of TIF district debt for redevelopment work on a brownfield area in addition to remediation. The Executive Director quoted a motion passed by VEPC on July 28, 2012 which stated, "at least one of the proposed redevelopment projects will cause the remediation and redevelopment of that site, and therefore, Project Criterion C, is met." The Director also referenced the statutory provision for project criteria "C," which states, "The project will affect the mitigation and redevelopment of a brownfield located within the district." Neither of these is evidence that VEPC approved the use of TIF district financing for redevelopment costs other than brownfield remediation on a brownfield area.</p> <p>VEPC's 2012 Final Determination letter, which authorized St. Albans to use incremental property tax revenues to finance public infrastructure debt incurred for the TIF district, states that "any references to infrastructure projects, real property development, parcel values, increments, etc. contained in this document <u>are stated as represented in the St. Albans TIF District application ...</u> considered by the Council on June 28, July 26, and August 30, 2012." We reviewed materials from the time of the St. Albans TIF district application⁵⁰ and none of these informed VEPC that TIF district debt would be used to fund site preparation/improvements on behalf of a hotel development project. We concluded that VEPC did not approve costs other than brownfield remediation for the hotel site and TIF district debt should not have been used to pay for costs that were not for brownfield remediation activities.</p>

⁵⁰ SAO reviewed the St. Albans TIF district plan, dated April 30, 2012, minutes for the April 30, 2012 St. Albans public hearing for the TIF district, TIF application Schedule 9E (Hotel Development Project Summary), TIF application attachments 8H and 8J (Brownfield Remediation Plans revised June 19, 2012), St. Albans' confidential memo dated May 20, 2012 to VEPC regarding private projects (including the hotel) in the TIF district, and VEPC meeting minutes from June 28, 2012, July 28, 2012, and August 30, 2012.

Appendix IX

SAO Evaluation of VEPC Comments

VEPC Response	SAO Comment
<p><i>"As this report outlines, Saint Albans submitted a revised financing plan through the Substantial Change process to VEPC in January of 2019. The request was approved by VEPC in February of 2019. This revised financing plan outlined the changes in costs and timeline of projects approved for the Saint Albans TIF District, all of which remained under the initial approved debt ceiling of \$23 million. The city has requested additional review by the Council through this process for determinations of issues raised in this report."</i></p>	<p>According to the Executive Director, a letter has not been sent to St. Albans following VEPC's approval of the City's January 2019 substantial change request because VEPC plans further review of the matter of whether TIF debt may be used to pay debt service for TIF debt and how the VEPC repayment condition may be implemented. Per the Executive Director, as part of deciding on these issues, VEPC intends to review the audit findings, the City attorney's legal opinion, and the guidance provided to the SAO by the AGO. VEPC has sought further guidance from the AGO and the Agency of Commerce and Community Development's legal counsel. VEPC also plans to hear from St. Albans and other interested parties at the May 30, 2019 VEPC meeting.</p>
<p><i>"Title 24 on Municipal Government and Title 32 on Taxation and Finance both address TIF. In the five-year audit of the Saint Albans TIF, the State Auditor's Office requested and received advice from the Attorney General's Office about a TIF District's use of debt proceeds from a TIF bond to pay debt service on the same. The opinion and resulting guidance were limited only to interpretation of the Title 24 statutes authorizing municipalities to incur debt - one set on general debt not connected to TIF and another on financing VEPC-approved TIF projects. It did not address the TIF's rationale or intention for using debt proceeds while waiting for increasing grand list values to generate sufficient increment to cover the payments. However, a number of applicable statutes in Title 32 bear directly on TIF and strongly suggest that a different answer is possible."</i></p>	<p>SAO met with the AGO on May 14, 2019, subsequent to receiving VEPC's comments on the draft audit report and the Attorney General confirmed that the previously issued opinion, which concluded that TIF debt proceeds may not be used to pay for debt service on TIF bonds, won't be changed.</p>

Appendix IX

SAO Evaluation of VEPC Comments

VEPC Response	SAO Comment
<p><i>"VEPC's request highlighted the practical impediment to paying debt service in the first years of the retention period when a TIF project has yet to benefit from an increase in annual April 1 grand list determinations to generate sufficient increment to fully cover the early debt service payments. Delayed access to tax increment would not cause a net cost increase to the municipality where the municipality used bond proceeds to pay TIF debt in the beginning."</i></p>	<p>As we noted in the audit report, the City's diversion of approximately \$1 million of debt proceeds to repay TIF district debt could have a negative effect on the amount of tax increment that will be generated over the life of the TIF district. This is because the \$1 million of debt proceeds haven't been used to fund improvements and it is improvements that are intended to incent the real property development that increases property values and generates tax increment.</p>